Report of the
Auditor General of Canada
to the House of Commons

1992 Main Points

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Preface

This is the fifth year we have produced this booklet of main points from the annual Report. It should be seen as one element in a continuing task. That task is to communicate clearly the results of our audits.

Our auditing has value only when we get our messages across: to Members of Parliament, to the government, to the taxpayers of Canada who provide the dollars the government spends.

The Auditor General's annual Report exceeds 600 pages of detailed information. Despite our best efforts, I recognize that it is not an easily accessible document. This is why we publish this booklet with the main points from each of this year's chapters.

The main points here are very abbreviated. When readers identify matters of interest to them, I urge them to go to the Report for the complete message.

The booklet has been well received in the past. I hope it continues to be a useful and convenient tool.

L. Denis Desautels.

L. Denis Desautels, FCA
Auditor General of Canada

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Matters of Special Importance and Interest

1.1 Chapter 1 focusses on issues that I believe are fundamental to achieving accountability in government and to enhancing our national institutions.

1.2 **Information for Parliament.** The Office recognizes that Parliament needs appropriate information from government departments and agencies to fulfil its role in responsible government. What information is relevant? This year's Report gives practical recommendations on this issue.

1.3 **Stewardship of the national debt.** I find that there is an ever–growing concern among taxpayers about the federal deficit and debt. We need to consider ways of improving the government's financial disclosure to help Canadians better understand and assess the significance of the deficit and debt.

1.4 **Truth in budgeting.** There is also a need to recognize and make visible, on a timely basis, any costs that may arise from federal credit programs such as loan guarantees.

1.5 **First Nations.** In the 1991 Report and again this year, the Office has identified the need to clarify the financial relationship between the government and First Nations. What should be the government's accountability for funding provided to First Nations?

1.6 **Protection of the environment.** Implementation of sustainable development requires integration and balancing of economic and environmental factors in all aspects of government decision making. What role should departments, agencies, regulators, my Office and other federal government auditors play in implementing this concept?

1.7 **Public service reform.** Taxpayers may well ask, "Will the government's current management reform initiative result in higher productivity, appropriate levels of service, higher morale, and greater cost–effectiveness?" In this chapter, I comment on the progress of the reform initiative.

1.8 **Information technology.** Government operations can be made more productive by the appropriate selection and application of new information technologies. However, ways need to be found to better manage the risks inherent in developing large computer systems.

Other Audit Observations

2.1 The Auditor General Act requires the Auditor General to include in his annual Report matters of significance that, in his opinion, should be brought to the attention of the House of Commons.

2.2 The Other Audit Observations chapter fulfils a special role in the annual Report. Other chapters normally describe the findings of the comprehensive audits we perform in particular departments; or they report on audits and studies of issues that relate to operations of the government as a whole. The Other Audit Observations chapter is used to report individual matters that have come to our attention during our financial and compliance audits of the Public Accounts of Canada, Crown corporations or other entities. It is also used to report some specific matters that have come to our attention during our comprehensive audits.

2.3 The chapter contains a wide range of observations on departmental operations. The issues addressed generally concern failure to comply with authorities, poor cash management practices, inadequate control over revenue and the expenditure of money without due regard to economy.

2.4 Although the individual audit notes report matters of significance, they should not be used as a basis for drawing wider conclusions about matters we did not examine.

3.1 Departments continue to make progress in correcting deficiencies, although it is slow in some areas.

3.2 **Immigration** – Departments involved in these activities have made good progress in implementing some of our recommendations. Improvements have been or are being made in the management of immigration levels, the automation of immigration activities at missions abroad, the control over access to the refugee system, and the initial refugee hearing process, but overall efficiency gains have yet to materialize in the foreign delivery of the Immigration Program. Medical screening procedures have also been reviewed and improvements made at Customs' primary inspection line. More needs to be done, however, in several areas including paper burden, training of personnel, development of efficiency norms and resource allocation abroad, security screening and removals.

3.3 **Department of the Environment – Conservation and Protection** – The Department has made satisfactory progress in many areas within the programs examined in 1991, including the release of its comprehensive environmental strategy, the Green Plan. However, with respect to the implementation of the Canadian Environmental Protection Act (CEPA) and sections 36 to 42 of the Fisheries Act, areas requiring further attention are identification of standards of environmental quality, levels of compliance required to achieve these standards, and assessment of the effectiveness of regulations. The 7 August 1992 ruling of the Superior Court of Quebec on CEPA, and the mandatory parliamentary review of the administration of the Act, might influence future action in these areas. In the Great Lakes, the federal program co–ordination structure has been strengthened, but action to implement changes is slow.

3.4 **Department of National Defence – Human Resource Management** – Progress has been satisfactory on some recommendations. Much remains to be done in several cases. The Department still needs to re–evaluate its Official Languages Program implementation in order to respond to identified needs. Work is still required to ensure that relevant, cost–effective and timely training is provided. The level of medical support required in peacetime to support unique military needs has yet to be defined.

3.5 **Department of the Secretary of State — Education Support** — In the area of Post–Secondary Education Support, progress has been slow. As for the Canada Student Loans Program, the Department is undertaking corrective measures. However, more needs to be done in formalizing and implementing agreements with provinces and in improving the management information system for student loans.

3.6 **Department of Transport — Airports** — While the Department has had some success with runway expansion, it still lacks a clear management strategy and a plan for financing capital needs.

3.7 **Reporting to Parliament** – This issue is addressed in Chapter 6 of this Report. A number of follow–up audits this year have indicated that problems identified previously have not yet been fully resolved.

Change and Control in the Federal Government

4.1 Public service reform will bring about changes in control at all levels of government. Some proposals would have an impact on how Parliament funds and scrutinizes government operations. The central agencies are already reducing central direction, to minimum basic rules. In departments and agencies, as much authority as possible is to be placed in the hands of front-line employees and managers, along with responsibility for ensuring that controls over the operations and resources entrusted to them are adequate. Public servants at all levels are to be more clearly accountable for their performance.

4.2 This study considers the effect of this reform on control at the levels of Parliament, ministers, central agencies and the departments and agencies that deliver programs to Canadians. It sets out some of the important issues that Parliament and the government need to address in changing the control framework.

4.3 It is well recognized that the timing, nature and location of controls could change. The government needs to make clear the control and accountability framework needed — its nature, what it would comprise, and what measures would be in place — to protect parliamentary control while safely guiding public servants who are being asked to innovate, to take greater risks and to be more accountable.

4.4 The government needs to manage the transformation in control carefully and report to Parliament on its progress. Sustained leadership at all levels of government is needed to carry these reforms through. As part of the change process, the adoption of a contemporary view of control — one that is oriented to achievement — is key in renewing management in the public service. In the chapter we suggest, as a matter of urgency, action steps for government to help ensure a successful transition to better management in the public service.

5.1 Today's organizations operate in a world of rapid and accelerating change. To stay relevant, effective and competitive, these organizations must learn at least as fast as their environment changes. This means maintaining a fit between the organizations' assumptions about reality and reality itself.

5.2 The learning organization views change not as a threat to be resisted, but as an opportunity to become more confident, responsive and effective.

5.3 The learning organization encourages its members at all levels to learn continually and to embed their skills and knowledge into its attitudes and practices.

5.4 Organizational learning is inspired by "learning champions." These are people who foster a sense of purpose, develop enlightened strategies, attract other committed people, and view work environments as continual learning structures through which service and performance can be improved.

5.5 The learning organization sees itself as part of an interactive partnership with its customers. This relationship involves a process of ongoing development through reciprocal feedback. Together, the partners create products and services that are valued by society.

5.6 The public service could foster organizational learning through experimental projects in a variety of areas. These projects would emphasize continuous learning as the basis for effective teamwork and for improvements in service and performance. Learning and innovation would gradually become dominant characteristics of the public service culture.

Information for Parliament

Departmental Reporting

6.1 In the early 1980s, the government reformed the Estimates and introduced a new package of information for Parliament on departmental spending: Part III of the Estimates. This change led to considerable improvement in reporting, but, as was generally agreed, it was limited to annual spending.

6.2 Yet the business of government is complex and the instruments it uses are varied, only some of which are reflected through annual spending. Parliament should expect and receive a regular accounting on the exercise of the entire business of government: in a phrase, global stewardship. The Part IIIs should change to meet this proposed global stewardship paradigm, and they should be produced and reported on a cycle that could vary among departments.

6.3 Both parliamentary committees and government departments would be better served by these cyclical, in–depth reviews of departmental "global stewardship" within the current system of annual parliamentary approval of the Estimates.

6.4 While this method of reporting would mean more and better information, it need not mean more printed text. Existing technology provides an emerging opportunity to produce shorter, stewardship–based printed Part IIIs with additional information stored in electronic libraries. This additional information would be updated at least annually and made available on request, electronically and in printed form.

6.5 Accounting for "global stewardship" does not end with a better Part III. Ministers' speeches, answers to questions in Parliament, testimonies before committees by ministers and officials are all occasions to satisfy the need for disclosure by government. The quality of reporting should be a preoccupation of the mind, in living up to the ideals of responsible government.

Payments to Employees Under the Work Force Adjustment Policy

7.1 The primary objective of the audit was to determine the extent to which payments in lieu and other related benefits granted between 1986 and 1991 under the Work Force Adjustment Policy were well founded and in keeping with the intent and letter of the Policy.

7.2 We found significant differences in the way the provision regarding payments in lieu was administered in departments. There were instances where it was well managed and instances where it was not managed in a satisfactory manner. In each case, there were some common characteristics.

7.3 Some 32 percent of the 396 payments examined were well founded and in keeping with the intent and letter of the Policy. Thirty–five percent were judged to be without foundation. In addition, we found that a number of payments — 29 percent — were called into question, given the reasons for and the circumstances in which they were made. We were unable to conclude in 4 percent of the cases. Our findings were indicative of trends and patterns, notably regarding payments made between April 1990 and December 1991.

7.4 While payments in lieu have facilitated work force adjustment situations, there has been a gradual deterioration in the administration of this provision, notably because of weaknesses in the management framework in departments and at the central agency level.

7.5 In our opinion, there is a need to clarify and better understand the roles and responsibilities of central agencies and departments and to ensure that all players concerned work in partnership. We suggest that there must be a change in mindset about empowerment, control and accountability. We also suggest that consideration be given to developing policies or mechanisms to deal with specific departmental problems such as work force renewal and other personnel problems. We believe that the emphasis needs to shift from reducing personnel to eliminating unnecessary and non–essential work. We also believe that there is a need for managers to absorb, or at least take into account, the full cost of their decisions regarding payments in lieu.

8.1 "Search and rescue" involves looking for and aiding people in distress. Although individuals are primarily responsible for their own safety, all levels of government, as well as members of the public, respond when people are in distress.

8.2 The times and locations of distress situations are not predictable, and no amount of resources can guarantee that all people will be saved. The federal government has located search and rescue resources at selected sites to respond to marine incidents in international and coastal waters and to air incidents. Other federal and non–federal resources are expected to, and do, respond to incidents in other areas. For air and marine incidents that are a federal responsibility, the federal government co–ordinates the response of all available resources.

8.3 Timeliness of response, which usually depends on the proximity of rescue resources to incidents, is a critical factor in saving people in distress. Our review of the reported air and marine distress incidents for 1989 and 1990 noted that even in areas where federal search and rescue resources were available, other resources often performed the rescue because they were closer to the scene.

8.4 The federal search and rescue system provides a reasonable response delivered by limited federal resources, volunteer groups and other resources. Federal resources play a key role in co–ordinating the response in air and marine incidents, but our analysis of distress incidents shows that federal search and rescue vessels and aircraft were instrumental in incident resolution less than 20 percent of the time. The search and rescue vessels of the Canadian Coast Guard played a key role in 12 percent of the reported marine distress incidents. The search and rescue aircraft of the Canadian Forces played a key role in 26 percent of the air and 3 percent of the marine distress incidents reported.

8.5 The requirement for federal search and rescue resources has the potential to be reduced by expanding the use of other federal and non–federal resources, such as the Canadian Marine Rescue Auxiliary.

8.6 Search and rescue patrol vessels often provide towing service to vessels requiring assistance. They provided critical assistance to a distress incident in the offshore area in one case. It should be possible to ensure that virtually the same extent of response for such incidents would be maintained by using other government vessels and vessels of opportunity, which are required to respond to distress incidents.

8.7 Information necessary to determine the need for search and rescue resources and alternatives for providing search and rescue services is incomplete.

8.8 Service standards, specifying a standard timeframe for resources to reach the incident site, have not been developed. Performance in relation to such standards should be used to assess the appropriateness of the location and extent of resources and, where applicable, the need to change the standards.

9.1 In an overall program context, Employment and Immigration Canada's (EIC) program evaluation has not examined the impact of its efforts on the labour market. However, the evaluations of program components were found to be of acceptable technical quality in terms of its selected measurement objectives.

9.2 We believe that the ongoing performance measurement system for some components audited should be enhanced to ensure that timely and complete effectiveness information is available at all management levels.

9.3 Given the large number of agreements at EIC, managers cannot be expected to exercise the same degree of control for each agreement. Control should vary with the level of risk and complexity of the agreement. In this regard, initial project approval is a crucial step for managers. However, vague project objectives, coupled with imprecisely defined local labour market needs and priorities, prevent EIC from selecting projects on the basis of merit. This situation increases the need for subsequent monitoring.

9.4 EIC does not respect its own minimum requirements for financial and activity monitoring practices. Furthermore, the Department does not have a strategy for choosing projects to be assessed at the end of the agreement. Limited information is derived from the monitoring of projects. More complete information resulting from the close–out assessment of projects would allow EIC to identify lessons learned that would improve subsequent project selection.

9.5 Although the Community Development Program relies on community–generated initiatives to improve the labour market situation, we found that few of the five–year strategic plans were truly strategic and that the data necessary to measure the impact of implemented initiatives were neither identified nor collected.

9.6 The eventual establishment of local labour boards could help EIC strengthen its mechanisms to ensure that funds available under the Unemployment Insurance Act for training are used effectively.

9.7 Parliament requires reliable information about EIC's activities and their effects on the labour market. It has been informed of EIC's mission, activity objectives and major lines of business. But it has not received evaluation evidence of the effectiveness of EIC's efforts to achieve its overall objective.

Loans to Sovereign States

10.1 Canada extends credit to individual sovereign states for many reasons: to promote development, to support foreign policy objectives and to facilitate export trade. Sovereign states owe Canada over $16 billion, of which $12 billion is owed to two Crown corporations — the Export Development Corporation and the Canadian Wheat Board.

10.2 The decision to extend credit to a country is complex and entails consideration of a number of factors, including those related to foreign and domestic policy, such as the promotion of Canadian agriculture. Granting credit to sovereign states also involves accepting risks. These risks take the form of delays or non-payment of loan interest or principal.

10.3 The government holds the view that sovereign loans are ultimately collectable unless formally repudiated. In 1990, in anticipation of debt relief measures agreed to by the international creditor community, the government provided an allowance for debt relief costs in its financial statements. Subsequently, in 1991, the government voluntarily provided debt relief to Poland and Egypt. These arrangements will cost Canada more than $3 billion over the next 18 to 25 years and will use up a substantial portion of its allowance.

10.4 Given the uncertain global economic outlook, the possibility that additional debt relief may be required, and the fact that many organizations including the World Bank now recognize, quantify and account for losses associated with loans to sovereign states, the government needs to assess whether its current policy is appropriate and realistic. It also needs to assess, on an annual basis, the value of these loans.

10.5 Parliament needs better information on Canada's overall sovereign loan exposure and the costs associated with it. For instance, on the matter of the 1991 debt relief to Poland and Egypt, Parliament has been told only that the costs of these arrangements would be $542 million over the first two years.

Canadian International Development Agency and the Regional Development Banks

11.1 The government views multilateral co–operation as important to achieving Canada's foreign policy objectives. Promoting development is an integral part of these objectives. Canada's involvement with the regional development banks is a significant and growing aspect of multilateral co–operation.

11.2 Canada's cumulative financial assistance to the banks has risen from $2.6 billion in 1983 to $6.2 billion in 1991. Per capita, Canada contributes more than any other G–7 country.

11.3 Canada's purpose for participating in the regional development banks has been articulated in the International Development (Financial Institutions) Assistance Act.

11.4 CIDA, and Parliament, need better information to know how effective Canada's participation in the regional development banks has been in promoting the social and economic advancement of developing countries. CIDA is working with each bank to improve effectiveness evaluations. So far the results have been mixed. A study on the effectiveness of the banks is under way in Canada by the North–South Institute. CIDA, along with six other funders, is actively participating in this study.

11.5 The matters for which the Minister is accountable to Parliament need to be clarified. It is reasonable to expect that the Minister be able to: provide an account to Parliament of the overall results achieved through the regional development banks; justify, based on these results, the extent of Canada's participation in each bank; and account for the specific means employed to achieve Canadian objectives in these international institutions.

11.6 Certain aspects of Canada's management, accounting, control and reporting procedures need to be re–examined. We have four concerns:

- There is a need for CIDA to enhance its analysis of the quality of the banks' loan portfolios.
- The accounting treatment of the $391 million Canada has paid as capital to the banks needs to be reconsidered. There is, for example, no expectation of financial return on this "asset".
- Canada has committed $3.7 billion to the banks as unpaid subscribed capital — in essence, guarantees that support the banks' borrowings. There is no explicit approval by Parliament of these guarantees.
- The Public Accounts do not show as liabilities the $1.1 billion in notes payable for moneys committed to the regional development banks, despite Canada's legal obligation to pay. This accounting treatment needs to be reconsidered.

Department of Finance

Participation in the Bretton Woods Institutions and in the European Bank for Reconstruction and Development

12.1 Canada pursues its economic and foreign policy objectives, in part, through its membership in the Bretton Woods and related institutions — the International Monetary Fund (IMF) and the World Bank Group — and the European Bank for Reconstruction and Development (EBRD). Canada's subscription (quota) at the IMF is $4.6 billion. Financial commitments in the World Bank Group and the EBRD are $5.6 billion.

12.2 The roles of the International Monetary Fund and the World Bank Group have evolved over time. Both are now concerned with broader socio–economic goals as well as the traditional objectives of stable balance–of–payments conditions and sustainable economic development, respectively. The international debt crisis, and the creation of the European Bank for Reconstruction and Development to help former communist bloc countries of eastern Europe, may increase the pressure on Canada and other creditor members for more financial support.

12.3 Several factors point to the need for the government to review the objectives, extent and results of Canada's participation in the Bretton Woods institutions, and weigh them against its financial commitments to these institutions and other demands on the public purse. These include the reported decline in the success rate of projects supported by the World Bank, the evolution in the roles and operations of the institutions, and domestic fiscal restraint.

12.4 Canada and some other creditor members have suggested that the World Bank continue to review its rate of loan loss provisioning, in view of the proportion of the loan portfolio that the Bank considered to be high risk and the uncertain global economic outlook.

12.5 The Department of Finance has improved the information it provides to Parliament and the public on Canada's participation. However, it needs to further improve the information on the objectives and results of participation and on the associated financial commitments and risks to which Canada is exposed.

12.6 We are concerned that, because of the vote wording in the Appropriation Act, Parliament is not made fully aware that it is approving a significant financial commitment of callable capital subscriptions when it approves payments to the World Bank.

13.1 Loan guarantees are one of the instruments the government uses to promote economic activities it favours. They are extended under loan guarantee programs or on an individual "ad hoc" basis. Outstanding loan guarantees amounted to $5.7 billion in 1990–91. The total authorized amount is about $13.7 billion.

13.2 In 1986, after the significant losses incurred earlier in the decade on loan guarantees, the government introduced guidelines to prevent future losses from affecting the deficit significantly. These guidelines were directed toward sharing the risks with lenders, investors and borrowers.

13.3 Risk sharing provides an incentive for lenders, investors and borrowers to act in ways that, while promoting the achievement of the government's goals, also minimize its financial risk. However, ongoing loan guarantee programs with lender risk–sharing arrangements cover only 26 percent of the total outstanding exposure. Although the guidelines suggest that a substantial portion of the funds should be provided by private sector equity, for ad hoc loan guarantees government assistance ranges from 74 percent to 103 percent of estimated project costs.

13.4 When a loan guarantee is authorized by Parliament through an appropriation vote of $1, it does not indicate a cost against which the government could subsequently be held accountable and this may give the impression that the guarantee is a free good.

13.5 In 1986, the government indicated that it would establish reserves in its financial statements to offset the potential costs associated with new loan guarantees. This has not been done and the potential costs remain unknown until such time as the government has to honour the guarantee.

13.6 The claim rates shown in the Public Accounts do not reflect fairly enough the loss rates of loan guarantee programs. Under the government's formula for estimating these rates, the expected loan losses on five programs we looked at amount to $122 million. A more appropriate formula indicates expected net loan losses of about $511 million for those same five programs.

13.7 Information to Parliament on the costs and risks of loan guarantees needs to be improved and simplified.

Department of Energy, Mines and Resources

Energy Megaprojects

14.1 We examined the energy megaprojects assisted and funded by the Department of Energy, Mines and Resources. Our observations on the Hibernia, Lloydminster Bi–Provincial Upgrader and Regina NewGrade Upgrader projects point to some fundamental weaknesses:

- lack of a comprehensive set of clear and measurable objectives;
- inadequate co–ordination of benefit monitoring;
- deficiencies in the follow–up of environmental assessment recommendations and commitments;
- continuing gaps in effectiveness measurement; and
- limited and poor reporting to Parliament and the public in Part III of the Main Estimates.

These are important concerns because of the magnitude, visibility and potential significance of current and possibly future megaprojects.

14.2 Clearly, means must be found to more effectively manage the federal interest in shared or joint projects that involve different levels of government and the private sector. Appropriate controls, including careful monitoring, are essential if federal interests are to be protected. Elaboration of central agency policies would contribute to better management of, and guidance to, the federal involvement in shared or joint projects.

14.3 The Department of Energy, Mines and Resources needs to better account for results: for what megaprojects have or have not achieved with taxpayers' money. It is not sufficient to control and account for financial expenditures only. It is also necessary to account for results in order to permit parliamentary and public scrutiny of the outcomes of expenditures.

INDIAN FOREST MANAGEMENT

15.1 The Department of Indian Affairs and Northern Development (DIAND) has not fully discharged its statutory responsibilities with regard to Indian forest lands.

15.2 The Timber Regulations established by DIAND to carry out these responsibilities are inappropriate and unenforceable.

15.3 Band consent is needed for entering reserves and for issuing logging permits, but the Crown has title over reserve lands. Management of reserve forest thus requires the co–operation of both parties.

15.4 DIAND and band councils lack adequate information to make effective decisions about Indian forest lands.

15.5 Significant sustainable social and economic benefits would be possible if Indian forests were better managed.

THE MANITOBA NORTHERN FLOOD AGREEMENT

15.6 Under the 1977 Northern Flood Agreement (NFA), the governments of Canada and Manitoba and Manitoba Hydro agreed to compensate five Indian bands for the adverse effects of hydro–electric development projects undertaken by Manitoba Hydro.

15.7 According to DIAND, the adverse effects included the flooding of up to 2,134 square kilometres of land, including 67 square kilometres of reserve land that is home to 10,000 status Indians.

15.8 The NFA is being implemented by a dispute resolution process rather than by a co–ordinated, co–operative effort by all parties. This is detrimental not only to the NFA parties, but also to the taxpayers of Canada, who ultimately pay the costs.

15.9 Certain environmental considerations have not been properly addressed, despite the federal government's knowledge of actual or potential dangers.

15.10 DIAND and other federal departments have spent over $115 million under the NFA (mostly since 1988), but they have not captured the total costs to date and they do not know what these are likely to be in the future. Under a 1990 proposal, the federal government would pay the bands an additional $78 million, not including ongoing normal funding.

Department of National Defence

Major Capital Projects
Industrial Development Initiatives

16.1 Value for money in major capital projects has three major objectives: the first and pre-eminent objective is meeting operational requirements in the most cost-effective manner; the second is achieving cost-effective, long-term industrial and regional development; and the third is achieving other national objectives. This chapter addresses the interplay between the first two of these.

16.2 Prior to 1985, it was common to seek offsets in major defence procurements. In 1985, a Ministerial Task Force concluded that offsets were costly and that expectations for incremental economic activity in Canada were overstated. The report called for a reassessment of government policies in order to place more emphasis on achieving benefits of lasting value and abandoning offset maximization. This resulted in greater emphasis being placed on achieving direct benefits.

16.3 Direct participation by Canadian industry in major capital projects may involve little or no additional cost in those areas where it is already competitive. In many cases, however, Canadian participation requires investments in such areas as design, infrastructure and labour force development that will increase costs to Canada compared to the costs when dealing with established foreign suppliers. Totally unique requirements, whether sourced in Canada or offshore, would require some form of investment.

16.4 We examined six DND major Crown projects (major capital projects costing over $100 million) under contract at the start of our audit to which industrial development initiatives had been attached, in whole or in part, under the current government policy. We found that the costs associated with these initiatives were significant and that generally they have not resulted in new industrial activity that is sustainable and competitive in domestic and world marketplaces, as required by current government policy. We also found instances where DND's operational requirements have been affected.

16.5 We recommended that steps be taken to improve strategic planning in this area; to provide decision-makers with adequate analyses of costs and benefits associated with industrial development initiatives; and to improve reporting to Parliament.

17.1 In the previous chapter on Major Capital Projects in the Department of National Defence (DND), we focussed on external factors at the beginning of the life cycle. In this chapter, we examine the effects of the systems, policies and procedures developed within the Department of National Defence that affect value for money in the procurement of major capital projects.

17.2 We found the Defence Planning and Force Development Process to be deficient in much the same way as its predecessor, the Policy Planning Process, which we reported in 1984. In its present form, it still does not provide an adequate basis for the unfolding of the Defence Program Management System. None of the projects we examined in our statistical sample was based on formally approved policy planning documents in the Defence Planning and Force Development process, and none had proceeded through the entire process as it is described in official DND documents.

17.3 We found the Defence Program Management System to be ineffective as well as cumbersome, and very expensive in terms of the resources devoted to it. The process simply has not been followed and did not appear to be workable in practice. These shortcomings, added to those identified in the previous chapter related to factors external to DND, have significant adverse impacts on the attainment of value for money.

17.4 Improvement of the Defence Planning and Force Development process is a prerequisite to improvement of the Defence Program Management System.

17.5 The program control process for the day–to–day management of the 550 major capital projects in the Defence Services Program is not described in the Defence Program Management System document or any other official DND document. There is no visible priority system for the entire matrix of projects and the Defence Services Program Information System, in its present form, does not provide a suitable basis for program control.

17.6 Most of the problems we observed – late delivery, cost escalation or failure to provide equipment that meets the operational requirement – were related to external and internal problems generated early in the project life cycle during project initiation.

17.7 In 1988 we reported that excessive amounts of spare parts were being procured and stocked by DND. In this audit, we found that the prices paid were also significantly higher than necessary.

18.1 The Canadian Forces Reserves are an essential component of the armed services. Reserves now cost about $750 million each year, and by the year 2000 will represent 46 percent of Canadian Forces personnel. Recent policy changes call for a revitalized Reserve that will play a more important role.

18.2 Our audit indicates that the Reserve system as it is presently constituted provides only limited military capability. The Department of National Defence has recognized many fundamental problems that must be addressed.

18.3 The Department will need to fill many gaps in planning. In particular, it will need to determine the most cost–effective roles and employment patterns for Reservists. Our audit indicates that, under the existing model, most of the cost advantage expected from the largest Reserve component is lost. The Department also needs to devise policies that will ensure reliable turnout of Reservists for training and in emergencies.

18.4 Existing human resource management processes for the most part do not respond to the part–time nature of the Reserves. Reserve occupations, training and promotion standards are disconnected from operational requirements, and training and promotion standards are not enforced. Systems, although under review, have not been designed to accommodate the limited availability of Reservists. With notable exceptions, the same applies to recognition of Reservists' civilian skills.

18.5 We identified problems with the acquisition of supplies, equipment and facilities that also reinforce the need for an approved and affordable plan for the Reserves. Capabilities are compromised because of funding problems, and the full rationale for projects is hard to determine in many cases.

18.6 Accountability for Reserve performance, both within the Department and to Parliament, needs to be dramatically improved.

18.7 The Canadian Forces recognize that overcoming these problems will probably be one of their greatest challenges over the next decade. Major reorganization, human resource management and re–equipment programs are being undertaken to address many of the issues raised by this audit.

19.1 The Special Import Measures Act provides a legislative framework to offer remedy to domestic producers against material injury caused by dumped or subsidized goods from other countries. The Department of National Revenue — Customs and Excise is primarily responsible for investigating allegations of dumping or subsidizing causing injury. The Canadian International Trade Tribunal conducts inquiries and makes findings relating to injury.

19.2 The Department has taken reasonable steps in initiating investigations and determining dumping. We observed some areas where the Department should maintain a broader perspective in considering injury during its investigation before making a preliminary determination. Further, there is a technical limitation arising from the legislation that precludes the Department from considering further evidence of injury when a case is referred to the Tribunal for advice at an early stage of the process.

19.3 Undertakings offered by foreign exporters or governments can serve as a less costly alternative to a full-length proceeding. However, they can easily be vetoed and terminated by any interested party, thereby rendering previous negotiations and efforts futile. Moreover, the Department needs to monitor undertakings closely to ensure that violations of their terms and conditions are detected promptly.

19.4 The Department conducted an evaluation study in 1988 and has used the results to improve its administration of the program. The Department of Finance, the department responsible for policy and legislation, has conducted ongoing monitoring of anti-dumping and countervailing cases, but it has not completed a formal evaluation of the program since the Act came into force in 1984. In our view, such evaluation effort is needed to determine if the balance of rights and obligations established in 1984 continues to be appropriate in the present trade environment, particularly in light of the ongoing Uruguay Round of Multilateral Trade Negotiations and the Canada-United States Free Trade Agreement.

Department of National Revenue – Customs and Excise

Goods and Services Tax: Registration and Related Sub–Activities

20.1 With only 20 months available from the time of the budget announcement and despite passage of the legislation on 17 December 1990, the Department managed to put systems and procedures in place to start administering the Goods and Services Tax (GST) by 1 January 1991.

20.2 The Department achieved its registration target of 1.6 million by April 1991. However, we observed that many follow–up and maintenance actions are still needed in the registration program, which limits its capacity to identify new registrants. In addition, many accounts were cancelled without proper supporting documentation and the requirement for certain pertinent data was dropped from the original design of the registration form.

20.3 The Department had implemented an extensive program to provide information to the public before the tax took effect. The demand for information services by telephone was massive in 1991–92, requiring resources to be redeployed from the registration program and other enforcement activities. In responding to written queries, the Department needs to reassess its target response time, prioritize the requests, explore ways to better communicate changes to users and work with the Department of Finance to recommend timely enactment of proposed legislative amendments.

20.4 Almost 1.6 million of the 1.7 million registrants are small businesses filing returns on a quarterly basis. Although legislation provides certain options for simplification, they were chosen by few small businesses. The Department has started to address concerns to help simplify administration for the small business sector and itself. We believe that further simplification has the potential for significant efficiency gains to both registrants and the Department.

20.5 The reporting of the start–up costs for GST was fragmented. Although many departments and agencies were involved, the overall costs were not consolidated and reported to Parliament. Furthermore, accountability and reporting for the development of the GST automated system, a major Crown project, need to be improved.

Resolving Disputes on Income Tax Assessments

21.1 Taxpayers who believe they have been treated unfairly are entitled to file an objection; this will initiate a review by National Revenue – Taxation appeals officers. Taxpayers who are not satisfied with the result of the review may appeal to the courts.

21.2 National Revenue – Taxation's Appeals Branch is committed to the impartial and timely resolution of taxpayers' disputes.

21.3 Appeals Branch's philosophy, organization and training is intended to foster impartiality. The Branch has some indicators of the extent to which it succeeds in its quest for fairness, but it is looking for further indicators. In particular, it is preparing to survey taxpayers on their perceptions.

21.4 Appeals Branch has grown in the face of an increasing workload and more exacting legislative requirements. Despite this growth in resources, the Branch is taking longer to resolve cases — on average over 3 months for simple ones and over 14 months for complex ones.

21.5 National Revenue – Taxation should make available to parliamentarians more information on performance in the dispute resolution process.

Royal Canadian Mounted Police

Provincial and Municipal Policing

22.1 A long–standing partnership. Through contractual arrangements the RCMP has, for decades, served as the provincial, territorial and municipal police in eight provinces (not Ontario and Quebec), the two territories and 191 municipalities. This long–standing partnership has stood the test of time and has conferred significant benefits on all parties involved.

22.2 Operational efficiency. The RCMP could improve its efficiency if more of its detachments would implement a "differential response strategy", and adopt a more efficient shift schedule. It also needs to make greater use of available technology and to improve the efficiency of its report writing. In addition, it should improve its performance measurement practices and rectify the problems associated with its management information systems.

22.3 A new focus — community–based policing. Over the last few years, a shift has occurred in policing philosophy that puts a much greater emphasis on community consultation and problem solving. The RCMP has been able to progress in a number of aspects of community–based policing, such as starting to hire visible minorities and establishing a community and aboriginal policing directorate. There are some delays, however. The Force has not developed guidelines that suggest how to better involve the community and improve local police operations. It is still in the process of adjusting its recruitment, training and other personnel policies and practices to match the needs of the new philosophy.

22.4 Sharing the cost. The federal government historically has never recovered the full cost of providing contract policing services because it believes that it receives certain benefits from the arrangement. The 1992 contract has added certain items to the negotiated cost base, according to which the provincial and municipal share of the costs is determined. The addition of these items means that the new negotiated cost base reflects more closely the actual cost to the federal government. We estimate, however, that there is a gap between the negotiated cost base and the actual cost, ranging from $100 million to $150 million. We are concerned that these actual cost figures are not clearly disclosed to Parliament. Furthermore, we believe that, when the contract is reviewed in five years, the federal government should attempt to negotiate from a cost base that includes all actual cost elements.

23.1 The management of human resources is the single most important factor in determining overall RCMP effectiveness. Knowledgeable, skilled and motivated individuals of high integrity are essential to effectively serving the Canadian public. These resources account for approximately 80 percent of the RCMP's $1.8 billion operating budget.

23.2 The RCMP operates in an evolving environment that increasingly demands re–examination of the way it conducts its operations and provides its services. The Force has recognized the need for change and has undertaken a series of major initiatives. A critical component of these initiatives has been the fundamental renewal of its human resource management systems and practices. Projects are under way in such key areas as recruitment, training, career management and member health.

23.3 During our audit we identified a number of areas for improvement: human resource planning, recruit selection, recruit training, refresher training and member career management. As stated above, the RCMP was in the process of addressing many of these areas. Given these initiatives and the importance of their success, we will be monitoring the Force's progress in these areas.

Emergency Preparedness in the Federal Government

24.1 We reviewed emergency preparedness in the federal government. We initially reported to Parliament on this area in 1987, and in 1990 the Standing Committee on Public Accounts requested us to review progress to date.

24.2 In general, long–standing problems in federal emergency planning are not being addressed within a reasonable time frame. For example:

- Five years after we raised the issue, the general part (Part I) of the National Earthquake Support Plan (NESP), which provides a framework for further planning, is nearing completion. However, Part II of the NESP — departmental emergency support function plans — is still being worked on.
- The Department of the Environment informed Cabinet in June 1991 that although a few of the recommendations of the 1986 Bhopal Aftermath Report have been implemented — for example, the establishment of the Major Industrial Accidents Council of Canada (MIACC) — there has been no follow–up action on most of the other important recommendations.
- A 1986 review of the Chernobyl experience recommended major improvements to the federal government's nuclear emergency response plan. Most of these have not been implemented or are in the early stages of development. Revision of the plan should be a priority.
- Mandates for departmental lead roles in emergency planning still need clarification and interdepartmental co–ordination still needs improvement.

24.3 We are concerned that the delays in developing co–ordinated plans for major emergencies will reduce the speed of the emergency response, which is a critical factor in saving lives and protecting property.

24.4 In our opinion, the delays are the result of several factors, including interdepartmental jurisdictional disputes, allocation of resources to other priorities, the complexity of co–ordinating plans with the provinces, and a lack of a sense of urgency, perhaps due to the absence of a recent major disaster in Canada.

24.5 The information provided to Parliament on the status of emergency preparedness on a government–wide basis is inadequate. The government's budget proposals calling for the ending of the requirement for annual departmental reports could almost eliminate disclosure of this information to Parliament unless an alternative method is used.

Rapport du vérificateur général du Canada à la Chambre des communes

Points saillants 1992

Rapport du

vérificateur général du Canada

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Avant-propos

La production de cette brochure qui renferme les points saillants tirés du Rapport annuel en est à sa cinquième année. Il faudrait la percevoir comme un élément qui se rattache à une tâche permanente : celle de communiquer avec clarté les résultats de nos vérifications.

Nos travaux de vérification ne valent que dans la mesure où nous pouvons transmettre les messages que nous véhiculons. Aux députés. Au gouvernement. Aux contribuables du Canada qui versent les dollars que dépense le gouvernement.

Le Rapport annuel du vérificateur général compte plus de 600 pages d'information en détails. Nous avons beau nous efforcer de le rendre accessible, il reste qu'il ne l'est pas facilement. C'est pourquoi nous publions cette brochure dans laquelle on retrouve les points saillants qui ont été tirés de chacun des chapitres de cette année.

Les points saillants qui suivent sont très abrégés. Lorsque les lecteurs relèvent des questions qui ont un certain intérêt pour eux, je leur demande instamment de consulter le Rapport pour prendre connaissance du message détaillé.

La brochure a été bien accueillie dans le passé. J'ose espérer qu'elle continuera de s'avérer un outil utile et pratique.

Le vérificateur général du Canada,

L. Denis Desautels, FCA

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1.1 Ce premier chapitre met l'accent sur des questions qui, à mon avis, sont fondamentales pour que se réalise la reddition des comptes au sein du gouvernement et que s'améliorent nos institutions nationales.

1.2 L'information destinée au Parlement. Le Bureau reconnaît que le Parlement a besoin d'une information appropriée de la part des ministères et des organismes du gouvernement pour jouer son rôle de gouvernement responsable. Quelle information est pertinente? Le Rapport de cette année donne des recommandations pratiques à ce sujet.

1.3 L'intendance de la dette nationale. Je me rends compte qu'il y a une inquiétude toujours grandissante chez les contribuables à l'égard du déficit fédéral et de la dette. Il nous faut étudier des moyens d'améliorer la divulgation de la situation financière du gouvernement afin d'aider les Canadiens et les Canadiennes à comprendre et à évaluer l'importance du déficit et de la dette.

1.4 La transparence dans la budgétisation. Il faut aussi comptabiliser et faire connaître en temps opportun les coûts qui pourraient découler des programmes de crédit fédéraux comme les garanties d'emprunts.

1.5 Les Premières nations. Dans le Rapport de 1991, et de nouveau dans celui de cette année, le Bureau reconnaît la nécessité de clarifier les relations financières entre le gouvernement et les Premières nations. Quelle devrait être la nature de la reddition de comptes du gouvernement pour le financement qu'il fournit aux Premières nations?

1.6 La protection de l'environnement. La mise en oeuvre du développement durable exige l'intégration et l'équilibre de facteurs économiques et environnementaux dans tous les aspects du processus décisionnel du gouvernement. Quel rôle les ministères, les organismes, les organes de réglementation, mon Bureau et les autres vérificateurs du gouvernement fédéral devraient-ils jouer dans la mise en oeuvre de ce concept?

1.7 La réforme de la fonction publique. Les contribuables pourraient bien se demander si le projet actuel du gouvernement de réformer la gestion de la fonction publique donnera lieu à une hausse de la productivité, à des niveaux de service appropriés, à une amélioration du moral et à un meilleur rapport coût-efficacité. Dans le présent chapitre, je formule des observations sur les progrès de cette initiative de réforme.

1.8 La technique informatique. Le gouvernement peut accroître la productivité de ses activités en choisissant et en appliquant de nouvelles techniques informatiques. Toutefois, il faut trouver des moyens de mieux gérer les risques inhérents à la mise au point de gros systèmes informatiques.

Autres observations de vérification

2.1 La *Loi sur le vérificateur général* exige du vérificateur général qu'il inclue dans son Rapport annuel les questions d'importance qui, à son avis, devraient être portées à l'attention de la Chambre des communes.

2.2 Le chapitre consacré aux Autres observations de vérification joue un rôle particulier dans le Rapport annuel. D'autres chapitres décrivent habituellement les constatations faites lors des vérifications intégrées que nous avons effectuées dans des ministères particuliers, ou bien ils donnent un compte rendu de vérifications et d'études qui portent sur des questions relatives aux activités du gouvernement dans son ensemble. Dans le chapitre qui porte sur les Autres observations de vérification, nous faisons rapport sur des faits distincts dont nous avons pris connaissance au cours de nos vérifications financières et de vérifications de conformité aux autorisations des Comptes publics du Canada, des états financiers des sociétés d'État et d'autres entités. Il sert également à présenter des questions précises que nous avons relevées lors de nos vérifications intégrées.

2.3 Le chapitre renferme toute une gamme d'observations sur les opérations des ministères. En général, les questions traitées portent sur la non–conformité aux autorisations, de mauvaises pratiques de gestion de trésorerie, des contrôles insuffisants exercés sur les recettes et des dépenses de deniers sans souci de l'économie.

2.4 Même si les notes de vérification particulières signalent des questions importantes, le lecteur ne doit pas s'en servir pour tirer des conclusions sur des points que nous n'avons pas examinés.

Suivi des recommandations formulées dans des rapports antérieurs

3.1 Les ministères continuent de combler des lacunes, quoique les progrès soient lents dans certains secteurs.

3.2 **Immigration** — Les ministères concernés par les activités en matière d'immigration ont réalisé des progrès appréciables dans la mise en oeuvre de certaines de nos recommandations. Des améliorations ont été apportées ou sont sur le point d'être apportées au chapitre de la gestion des niveaux d'immigration, de l'automatisation des activités relatives à l'immigration dans les missions du Canada à l'étranger, du contrôle de l'accès au processus de détermination du statut de réfugié et de la rationalisation de l'audience initiale. Néanmoins, l'amélioration globale de l'efficience reste à se matérialiser en ce qui concerne l'exécution du programme d'immigration à l'étranger. Les procédés d'examen médical ont aussi été revus et des améliorations ont été apportées à la ligne d'inspection primaire des Douanes. Il reste encore à faire dans plusieurs secteurs, notamment la paperasserie, la formation du personnel, l'élaboration de normes d'efficience et l'affectation des ressources à l'étranger, les examens sécuritaires et les renvois.

3.3 **Le ministère de l'Environnement — Conservation et Protection** — Le ministère a fait des progrès satisfaisants dans nombre de secteurs des programmes examinés en 1991, entre autres, en faisant paraître sa stratégie environnementale globale, le Plan vert. Toutefois, en ce qui concerne la mise en application de la *Loi canadienne sur la protection de l'environnement* (LGPE) et des articles 36 à 42 de la *Loi sur les pêches*, les domaines suivants requièrent une plus grande attention : l'établissement de normes sur la qualité de l'environnement, le degré de conformité nécessaire au respect de ces normes et l'évaluation de l'efficacité des règlements. Il est possible que le jugement rendu à propos de la LCPE par la Cour supérieure du Québec, en date du 7 août 1992, de même que l'examen obligatoire par le Parlement de l'administration de la loi influencent les mesures prises relativement à ces questions. Pour ce qui est des Grands Lacs, la structure de coordination des programmes fédéraux a été consolidée, mais la mise en oeuvre des changements est lente.

3.4 **Le ministère de la Défense nationale — Gestion des ressources humaines** — Les progrès réalisés par rapport à certaines recommandations sont satisfaisants, mais il reste beaucoup à faire dans nombre de cas. Il reste toujours au ministère à réévaluer la mise en oeuvre de son Programme des langues officielles afin de satisfaire aux besoins qui ont été relevés. Il doit encore travailler à assurer que la formation est pertinente, rentable et offerte en temps opportun. Il reste à déterminer l'importance des services médicaux à offrir, à l'appui des besoins uniques des Forces armées en temps de paix.

3.5 **Le ministère du Secrétariat d'État — Aide à l'enseignement** — Dans le secteur de l'aide à l'enseignement postsecondaire, les progrès ont été lents. Quant au Programme canadien de prêts aux étudiants, le ministère entreprend des mesures correctives. Toutefois, il y a encore beaucoup à faire pour rendre officielles et mettre en oeuvre les ententes avec les provinces et pour améliorer le système d'information de gestion visant les prêts aux étudiants.

3.6 **Le ministère des Transports — Les aéroports** — Le ministère a réussi en quelque sorte à faire agrandir des pistes, mais il n'a toujours pas de stratégie ni de plan de gestion précis pour le financement des immobilisations nécessaires.

3.7 **Rapports au Parlement** — Cette question est abordée au chapitre 6 du présent rapport. Un certain nombre de suivis effectués au cours de l'année ont indiqué que des problèmes déjà relevés n'ont pourtant pas encore été complètement résolus.

4.1 La réforme de la fonction publique entraînera des changements dans le contrôle à tous les niveaux du gouvernement. Certaines propositions auront des incidences sur la façon dont le Parlement finance et examine les opérations gouvernementales. Les organismes centraux diffusent déjà moins d'instructions émanant de l'administration centrale et s'en tiennent au minimum de règles de base nécessaires. Dans les ministères et organismes, on confiera autant de pouvoirs que possible aux employés et aux gestionnaires de première ligne tout en leur demandant de s'assurer que les contrôles exercés sur les activités et les opérations dont ils ont la responsabilité sont appropriés. Les fonctionnaires à tous les niveaux auront une responsabilité plus claire à l'égard de leur rendement.

4.2 La présente étude porte sur l'incidence que cette réforme pourrait avoir sur le contrôle aux niveaux du Parlement, des ministres, des organismes centraux et des ministères et organismes qui exécutent des programmes pour les Canadiens et les Canadiennes. Elle présente certaines des questions importantes que le Parlement et le gouvernement doivent régler pour changer le cadre de contrôle.

4.3 Tous reconnaissent que le moment, la nature et l'emplacement des contrôles pourraient changer. Le gouvernement doit indiquer clairement le cadre de contrôle et de reddition des comptes nécessaire – sa nature, de quoi il serait composé et quelles mesures l'on mettrait en place pour protéger le contrôle parlementaire tout en guidant bien les fonctionnaires à qui l'on a demandé d'innover, de prendre plus de risques et d'être davantage responsables.

4.4 Le gouvernement doit gérer avec prudence la transformation touchant le contrôle et rendre compte de ses progrès au Parlement. Il doit y avoir un leadership soutenu à tous les niveaux du gouvernement si ce dernier veut mener à bien cette réforme. Dans le cadre du processus de changement, l'adoption d'une vision moderne du contrôle – un contrôle axé sur les réalisations – est essentielle au renouvellement de la gestion dans la fonction publique. Dans le présent chapitre, nous proposons des mesures pressantes pour que le gouvernement facilite une transition réussie vers une gestion de meilleure qualité au sein de la fonction publique.

L'organisation évolutive

5.1 Les organisations modernes évoluent dans un monde en mutation rapide et qui va s'accélérant. Dans ces circonstances, leur rythme d'apprentissage doit, au bas mot, se comparer à celui du changement qui touche leur milieu pour qu'elles demeurent utiles, efficaces et concurrentielles. Pour ce faire, les hypothèses que formulent les organisations doivent toujours concorder avec la réalité même.

5.2 L'organisation évolutive considère le changement non comme une menace à laquelle il lui faut résister mais, au contraire, comme l'occasion d'acquérir de la confiance, de mieux répondre à la demande et d'être plus efficace.

5.3 L'organisation évolutive encourage ses membres, à tous les paliers, à poursuivre sans cesse leur apprentissage et à enchâsser leurs compétences et leurs connaissances dans les attitudes et les méthodes qu'elle adopte.

5.4 L'apprentissage au sein de l'organisation est animé par des «champions» en la matière. Il s'agit de gens qui favorisent le sentiment d'un idéal à atteindre, élaborent des stratégies éclairées, attirent des collaborateurs engagés et envisagent le milieu de travail comme une structure d'apprentissage permanente grâce à laquelle on améliore service et rendement.

5.5 L'organisation évolutive se considère comme associée dans un partenariat interactif avec sa clientèle. La relation entre les deux parties les engage dans un processus constant d'évolution grâce à la rétroaction. Ensemble, les partenaires sont à l'origine de produits et de services que la société valorise.

5.6 La fonction publique pourrait favoriser l'apprentissage organisationnel en lançant des projets pilotes dans divers secteurs. Ces projets mettraient l'accent sur l'apprentissage continu en tant que pierre angulaire du travail d'équipe efficace et des améliorations à apporter au service et au rendement. Il s'ensuivrait que l'apprentissage et l'innovation deviendraient progressivement des traits dominants de la culture de la fonction publique.

Rapports des ministères

6.1 Au début des années quatre-vingts, le gouvernement a remanié le Budget des dépenses et introduit un nouvel instrument conçu pour fournir au Parlement de l'information sur les dépenses des ministères, à savoir la Partie III du Budget des dépenses. Ce changement a donné lieu à une amélioration considérable de la présentation de l'information, mais, comme on en avait généralement convenu, cette amélioration s'est limitée à l'information sur les dépenses annuelles.

6.2 Pourtant, les opérations du gouvernement sont complexes et les instruments dont il se sert sont variés, mais seuls certains d'entre eux sont reflétés par les dépenses annuelles. Le Parlement est en droit d'attendre et de recevoir régulièrement des comptes sur l'ensemble des opérations du gouvernement, en d'autres mots, sur l'intendance globale. Les Parties III devraient être modifiées de manière à fournir de l'information sur cette intendance globale, et elles devraient être produites et déposées suivant un cycle qui pourrait varier d'un ministère à l'autre.

6.3 Tant les comités parlementaires que les ministères du gouvernement seraient mieux servis par ces examens cycliques approfondis de l'intendance globale des ministères, lesquels seraient effectués dans le cadre de l'actuel système d'approbation annuelle du Budget des dépenses par le Parlement.

6.4 Cette méthode donnerait lieu à une information plus considérable et plus utile, mais elle ne se traduirait pas nécessairement par plus de pages d'imprimés. Les techniques actuelles permettent de produire des Parties III axées sur l'information sur l'intendance plus courtes, l'information supplémentaire étant stockée dans des bibliothèques électroniques. Cette information supplémentaire serait mise à jour au moins une fois par année et fournie sur demande, sous forme électronique ou imprimée.

6.5 Rendre compte de l'intendance globale ne se termine pas avec la présentation d'une meilleure Partie III. Les discours des ministres, les réponses aux questions posées en Chambre, les témoignages des ministres et des représentants de ministères devant les comités constituent tous des occasions de satisfaire au besoin de transparence du gouvernement. La qualité de l'information communiquée devrait préoccuper constamment une administration qui veut être à la hauteur de l'idéal d'un gouvernement responsable.

Paiements versés aux employés en vertu de la Politique sur le réaménagement des effectifs

7.1 L'objectif premier de la vérification entreprise visait à déterminer dans quelle mesure les paiements forfaitaires et les avantages connexes consentis entre 1986 et 1991, en vertu de la Politique sur le réaménagement des effectifs, étaient bien fondés et conformes à l'esprit et à la lettre de cette dernière.

7.2 Nous avons constaté des différences importantes dans la façon des ministères de gérer les dispositions de la Politique concernant le paiement forfaitaire. Dans certains cas, ces dispositions étaient bien gérées, dans d'autres cas, leur gestion laissait fortement à désirer. Dans un cas comme dans l'autre, il y avait des caractéristiques communes.

7.3 Quelque 32 p. 100 des 396 paiements forfaitaires examinés ont été jugés bien fondés et conformes à l'esprit et à la lettre de la Politique. Par contre, 35 p. 100 ont été trouvés sans fondement. Nous avons jugé, en outre, qu'un nombre appréciable de paiements — 29 p. 100 — étaient «discutables», étant donné les raisons et les circonstances dans lesquelles ils avaient été consentis. Nous n'avons pas été en mesure de conclure dans quatre pour cent des cas. Nos observations reflètent les tendances et les orientations, notamment pour les paiements accordés durant la période comprise entre avril 1990 et décembre 1991.

7.4 Bien que le paiement forfaitaire ait facilité le réaménagement des effectifs, il y a eu une détérioration progressive de la gestion des dispositions de la Politique en ce qui a trait aux paiements forfaitaires, notamment à cause des carences dans le cadre de gestion, dans les ministères et au niveau des organismes centraux.

7.5 À notre avis, il faut clarifier et mieux comprendre les rôles et les responsabilités des organismes centraux et des ministères et faire en sorte que tous les intervenants travaillent en «partenariat». Nous suggérons la nécessité d'un changement dans la compréhension qu'ont les gens de l'habilitation, du contrôle et de l'obligation de rendre compte. Nous suggérons également que l'on considère l'élaboration de politiques ou de mécanismes pour régler des problèmes particuliers dans les ministères comme ceux que posent le renouvellement des effectifs et d'autres problèmes de personnel. Nous croyons qu'il faut se préoccuper davantage de supprimer le travail superflu ou non indispensable que de réduire les effectifs. Il faut aussi amener les gestionnaires à défrayer, ou au moins à prendre en ligne de compte, la totalité des coûts qu'occasionnent leurs décisions d'accorder des paiements forfaitaires.

8.1 Le terme «recherche et sauvetage» désigne les mesures prises pour localiser et aider les personnes en détresse. Bien que chaque personne soit responsable au premier chef de sa propre sécurité, tous les ordres de gouvernement, ainsi que certains particuliers, interviennent lorsque des gens sont en détresse.

8.2 Il est impossible de prévoir où et quand surviendront des incidents de détresse et de garantir le sauvetage de toutes les personnes en danger, quelles que soient les ressources disponibles. Le gouvernement fédéral a affecté des ressources de recherche et de sauvetage à des endroits choisis pour pouvoir intervenir en cas d'incident maritime dans les eaux internationales ou côtières et en cas d'incident aérien. On compte sur des ressources secondaires, fédérales et non fédérales, pour assurer ces services dans les autres secteurs, ce qu'elles font d'ailleurs. Pour les incidents maritimes et aériens qui surviennent dans les régions relevant de sa compétence, le gouvernement fédéral coordonne l'intervention des ressources disponibles.

8.3 La rapidité de l'intervention, qui dépend habituellement de la proximité des ressources, est un facteur clé quand il s'agit de sauver des gens en détresse. En examinant les cas d'incidents aériens et maritimes signalés en 1989 et 1990, nous avons remarqué que, même là où des ressources fédérales de recherche et de sauvetage étaient disponibles, d'autres intervenants ont souvent accompli le sauvetage parce qu'ils se trouvaient plus près des lieux de l'incident.

8.4 Le système fédéral de recherche et de sauvetage permet de fournir une intervention raisonnable à l'aide de ressources fédérales restreintes, de groupes de bénévoles et d'autres ressources. Les ressources fédérales jouent un rôle clé de coordination des interventions dans le cas des incidents aériens et maritimes. Toutefois, notre analyse des cas de détresse indique que les navires et les aéronefs fédéraux de recherche et de sauvetage ont contribué pour moins de 20 p. 100 au dénouement des cas. Les navires de la Garde côtière canadienne affectés aux opérations de recherche et de sauvetage ont joué un rôle clé dans le dénouement de 12 p. 100 des cas de détresse maritimes signalés. Les aéronefs des Forces canadiennes utilisés pour les opérations de recherche et de sauvetage se sont avérés un élément clé dans le dénouement de 26 p. 100 des cas de détresse mettant en cause des aéronefs, ce pourcentage étant de 3 p. 100 pour le dénouement des cas de détresse maritimes signalés.

8.5 On pourrait réduire le besoin en ressources fédérales de recherche et de sauvetage en faisant davantage appel à d'autres ressources, fédérales et non fédérales, comme le Service auxiliaire canadien de sauvetage maritime.

8.6 Les navires de patrouille affectés à des opérations de recherche et de sauvetage assurent souvent des services de touage aux navires qui ont besoin d'aide. Dans un incident de détresse en haute mer, leur intervention s'est avérée d'importance capitale. Il devrait être possible d'offrir dans les mêmes circonstances le même genre d'intervention grâce à l'utilisation d'autres navires gouvernementaux et des navires alors disponibles, lesquels doivent porter secours en cas d'incident de détresse.

8.7 Les informations nécessaires pour déterminer le besoin en ressources de recherche et de sauvetage ainsi que les autres moyens d'assurer les services à cet effet sont incomplètes.

8.8 Des normes de service précisant les délais dans lesquels les ressources devraient arriver sur les lieux de l'incident n'ont pas été élaborées. Il serait ensuite possible, en mesurant le rendement par rapport à de telles normes, de déterminer si les ressources sont suffisantes et réparties aux bons endroits et s'il y a lieu de modifier les normes.

9.1 Pour l'ensemble du programme, l'évaluation de programme d'Emploi et Immigration Canada n'a pas tenu compte de l'incidence des efforts d'EIC sur le marché du travail. Toutefois, nous avons jugé que les évaluations des composantes de programme étaient acceptables sur le plan de la qualité technique lorsqu'on les considérait à la lumière des objectifs de mesure choisis par le ministère.

9.2 Nous sommes d'avis que l'on devrait améliorer le système de mesure continue du rendement pour certaines des composantes vérifiées afin d'assurer des renseignements complets et opportuns sur l'efficacité, disponibles à tous les niveaux de gestion.

9.3 Compte tenu du grand nombre d'accords conclus par EIC, on ne peut s'attendre à ce que les gestionnaires exercent le même degré de contrôle sur chacun. Celui–ci devrait s'adapter au niveau de risque et à la complexité de l'accord. À cet égard, l'approbation initiale du projet est une étape cruciale pour les gestionnaires. Toutefois, des objectifs de projet vagues, associés à des priorités et à des besoins du marché du travail mal définis, ne permettent pas à EIC de choisir les projets les plus méritoires. Par la suite, cette situation accroît le besoin de surveillance.

9.4 EIC ne respecte pas ses propres exigences minimales quant aux pratiques de surveillance des finances et des activités. De plus, le ministère n'a pas de stratégie pour sélectionner les projets à évaluer à la fin d'un accord. La surveillance des projets ne permet de recueillir que des renseignements limités. Des renseignements plus complets recueillis à l'évaluation finale des projets permettraient à EIC de tirer des leçons susceptibles d'améliorer la sélection des projets à venir.

9.5 Même si le Programme de développement des collectivités compte sur des initiatives d'origine communautaire pour améliorer la situation du marché du travail, nous avons constaté que peu de plans stratégiques quinquennaux sont vraiment stratégiques et que les données nécessaires à la mesure de l'incidence des initiatives mises en oeuvre ne sont ni délimitées ni recueillies.

9.6 La création éventuelle de commissions locales pourrait aider EIC à renforcer les moyens de s'assurer que les fonds disponibles pour la formation en vertu de la *Loi sur l'assurance–chômage* sont utilisés de façon efficace.

9.7 Le Parlement a besoin d'information fiable au sujet des activités d'EIC et de leurs répercussions sur le marché du travail. Il a été informé au sujet de la mission d'EIC, de ses objectifs et des principaux secteurs d'intervention. Il n'a toutefois pas reçu de renseignements d'évaluation indiquant que les efforts d'EIC lui permettaient d'atteindre ses objectifs globaux de manière efficace.

Les prêts consentis aux États souverains

10.1 Le Canada octroie des crédits à des États souverains pour un grand nombre de raisons : favoriser le développement, soutenir des objectifs de la politique étrangère et faciliter le commerce extérieur. Des États souverains doivent au Canada plus de 16 milliards de dollars, dont 12 milliards sont dus à deux sociétés d'État, à savoir la Société pour l'expansion des exportations et la Commission canadienne du blé.

10.2 La décision de consentir des crédits à un pays est complexe et suppose la prise en considération d'un certain nombre de facteurs, notamment de facteurs liés à la politique étrangère et intérieure, comme la stimulation de l'agriculture canadienne. L'octroi de crédits à un État souverain suppose aussi que l'on accepte des risques, qu'il s'agisse de retards ou du non–remboursement de l'intérêt ou du principal du prêt.

10.3 Le gouvernement estime que les sommes prêtées aux États souverains sont ultimement recouvrables, à moins que la dette ne soit officiellement répudiée. En 1990, le gouvernement a établi, dans ses états financiers, une provision pour les coûts liés aux allégements de dette en prévision des mesures d'allégement acceptées par la communauté créancière internationale. Plus tard, en 1991, le gouvernement a volontairement accordé un allégement de dette à la Pologne et à l'Égypte. Ces dispositions coûteront plus de 3 milliards de dollars au Canada au cours des 18 à 25 prochaines années et épuiseront une part considérable de sa provision.

10.4 En raison de l'incertitude de la conjoncture économique mondiale, de la possibilité que d'autres allégements de dette soient nécessaires et du fait que beaucoup d'organisations, y compris la Banque mondiale, reconnaissent, quantifient et comptabilisent désormais les pertes liées aux prêts aux États souverains, le gouvernement doit déterminer si sa politique actuelle est adéquate et réaliste. Il doit aussi procéder à une évaluation annuelle de la valeur de ces prêts.

10.5 Le Parlement a besoin d'une meilleure information sur l'engagement global du Canada au titre des prêts aux États souverains et sur les coûts qui en découlent. Par exemple, pour ce qui est de l'allégement de dette consenti à la Pologne et à l'Égypte en 1991, on a seulement indiqué au Parlement que les coûts des mesures prises s'établiraient à 542 millions de dollars pour les deux premières années.

L'Agence canadienne de développement international et les banques régionales de développement

11.1 Le gouvernement considère la coopération multilatérale comme un élément important pour la réalisation des objectifs de la politique étrangère du Canada. La promotion du développement fait partie intégrante de ces objectifs. La participation du Canada aux banques régionales de développement est un aspect important de la coopération multilatérale, qui augmente sans cesse.

11.2 L'aide financière cumulative consentie aux banques par le Canada est passée de 2,6 milliards de dollars en 1983 à 6,2 milliards de dollars en 1991. La contribution du Canada, par habitant, est supérieure à celle de tout autre pays du G–7.

11.3 L'objectif de la participation du Canada aux banques régionales de développement est énoncé dans la *Loi d'aide au développement international (institutions financières)*.

11.4 Une meilleure information est nécessaire pour que l'ACDI et le Parlement puissent déterminer si la participation du Canada aux banques régionales de développement favorise d'une manière efficace l'avancement économique et social des pays en développement. L'ACDI collabore avec chacune des banques régionales pour améliorer les évaluations de l'efficacité. Jusqu'à maintenant, les résultats varient. L'Institut Nord–Sud effectue actuellement au Canada une étude de l'efficacité des banques régionales. L'ACDI, ainsi que six autres bailleurs de fonds, participe à cette étude.

11.5 Les questions dont le ministre doit rendre compte au Parlement doivent être clarifiées. Il est raisonnable de s'attendre à ce que le ministre soit en mesure de rendre compte au Parlement des résultats généraux obtenus grâce aux banques régionales de développement, à ce qu'il justifie, à partir de ces résultats, l'ampleur de la participation du Canada dans chacune des banques régionales et à ce qu'il rende compte des mesures précises adoptées pour atteindre les objectifs du Canada par l'intermédiaire de ces institutions financières.

11.6 Certains aspects des méthodes de gestion, de comptabilité, de contrôle et de rapport du Canada doivent être réexaminés. Quatre points nous préoccupent plus particulièrement :

- L'ACDI doit faire une meilleure analyse des portefeuilles de prêts des banques.
- Le traitement comptable du capital versé par le Canada aux banques régionales, soit 391 millions de dollars, doit être revu. Le Canada ne s'attend pas à tirer de rendement financier de cet «actif».
- Le Canada s'est engagé à verser 3,7 milliards de dollars aux banques régionales à titre de capital souscrit, sujet à appel; essentiellement, cette somme sert à garantir les emprunts des banques. Ces garanties n'ont pas été approuvées explicitement par le Parlement.
- Les effets à payer en raison des engagements financiers pris à l'égard des banques régionales de développement, qui s'élèvent à 1,1 milliard de dollars, ne figurent pas au passif dans les Comptes publics, bien que le Canada soit légalement tenu de remplir ses engagements. Il y a lieu de reconsidérer ce traitement comptable.

Le ministère des Finances

Participation aux institutions de Bretton Woods et à la Banque européenne pour la reconstruction et le développement

12.1 Le Canada poursuit ses objectifs en matière de politique économique et extérieure de diverses manières, notamment en participant aux institutions de Bretton Woods et aux institutions connexes, soit le Fonds monétaire international (FMI) et le Groupe de la Banque mondiale, ainsi qu'à la Banque européenne pour la reconstruction et le développement. La quote–part (la souscription) du Canada au FMI est de 4,6 milliards de dollars. Ses engagements financiers dans le Groupe de la Banque mondiale et dans la Banque européenne pour la reconstruction et le développement s'élèvent à 5,6 milliards de dollars.

12.2 Le rôle du Fonds monétaire international et celui du Groupe de la Banque mondiale ont évolué avec le temps. L'un et l'autre poursuivent maintenant des buts socio–économiques plus vastes, en plus de leurs objectifs traditionnels et respectifs d'équilibre de la balance des paiements et de développement économique durable. La crise de la dette internationale et la création de la Banque européenne pour la reconstruction et le développement, en vue d'aider les anciens pays du bloc communiste de l'Europe de l'Est, pourraient mettre le Canada et les autres membres créanciers dans une position où ils auraient à accroître leur aide financière.

12.3 Plusieurs facteurs indiquent que le gouvernement doit revoir les objectifs et l'ampleur de sa participation aux institutions de Bretton Woods, et les résultats qui en découlent, en regard des engagements financiers qu'il a pris envers ces institutions et de ses autres impératifs financiers. Parmi ces facteurs figurent un taux de succès à la baisse des projets qu'appuie la Banque mondiale, l'évolution des rôles et de l'activité des institutions et les compressions budgétaires en vigueur au Canada.

12.4 Le Canada et d'autres membres créanciers ont proposé que la Banque mondiale continue de réexaminer sa dotation aux provisions pour pertes sur prêts, eu égard à la part importante des prêts assortis de risques élevés figurant dans son portefeuille et à la précarité des perspectives économiques mondiales.

12.4 Le ministère des Finances a amélioré l'information qu'il présente au Parlement et au public concernant la participation du Canada aux institutions de Bretton Woods. Il doit toutefois améliorer davantage les renseignements portant sur les objectifs de cette participation, sur les résultats qu'elle donne, de même que sur les engagements et sur les risques financiers connexes auxquels le Canada est exposé.

12.6 Nous craignons qu'en raison du libellé de la Loi de crédits, le Parlement ne soit pas pleinement mis au courant du fait qu'il approuve un engagement financier important sous forme de souscriptions de capital exigibles lorsqu'il approuve les paiements à la Banque mondiale.

13.1 Les garanties d'emprunts, également appelées garanties de prêts, sont l'un des instruments dont le gouvernement se sert pour promouvoir les activités économiques de son choix. Elles sont accordées dans le cadre de programmes établis à cet effet, ou selon les besoins (garanties spéciales). L'encours des garanties d'emprunts s'élevait à 5,7 milliards de dollars en 1990–1991. Le montant total autorisé se chiffre à environ 13,7 milliards de dollars.

13.2 En 1986, après les pertes importantes subies au début de la décennie au titre des garanties d'emprunts, le gouvernement a établi des lignes directrices visant à éviter que les futures pertes n'influent de manière notable sur le déficit. Ces lignes directrices avaient également pour objet d'en venir à un partage des risques avec les prêteurs, les investisseurs et les emprunteurs.

13.3 Le partage des risques incite les prêteurs, les investisseurs et les emprunteurs à agir de façons qui, tout en contribuant à l'atteinte des objectifs du gouvernement, minimisent aussi ses risques financiers. Toutefois, les programmes de garanties d'emprunts existants, assortis de dispositions de partage des risques avec les prêteurs, n'interviennent que pour 26 p. 100 de l'encours des engagements. Même si les lignes directrices indiquent qu'une part importante des fonds devrait provenir du secteur privé, pour les garanties d'emprunts spéciales, l'aide gouvernementale se chiffre entre 74 et 103 p. 100 des coûts de projet estimatifs.

13.4 Lorsque le Parlement autorise une garantie d'emprunt en votant un crédit de un dollar, cela ne permet pas de fixer un coût dont le gouvernement pourrait être subséquemment tenu responsable et peut donner l'impression que la garantie est gratuite.

13.5 En 1986, le gouvernement a indiqué qu'il allait établir une réserve dans ses états financiers pour compenser les coûts éventuels associés aux nouvelles garanties d'emprunts. Il ne l'a pas fait, et les coûts éventuels demeurent inconnus jusqu'à ce qu'il doive honorer la garantie.

13.6 Les taux d'indemnité figurant dans les Comptes publics ne reflètent pas avec suffisamment de justesse les taux de perte des programmes de garanties d'emprunts. Selon la formule utilisée par le gouvernement pour estimer ces taux, les pertes sur prêts que celui–ci pourrait subir relativement aux cinq programmes que nous avons examinés s'élèvent à 122 millions de dollars. D'après une formule convenant mieux à la situation, les pertes nettes liées à ces cinq programmes pourraient se chiffrer à quelque 511 millions de dollars.

13.7 L'information transmise au Parlement en ce qui concerne les coûts et les risques relatifs aux garanties d'emprunts devrait être améliorée et simplifiée.

Le ministère de l'Énergie, des Mines et des Ressources

Les mégaprojets énergétiques

14.1 Nous avons examiné les mégaprojets énergétiques qui reçoivent une aide et un financement du ministère de l'Énergie, des Mines et des Ressources. Notre étude des projets de mise en valeur du champ Hibernia, de l'usine de valorisation biprovinciale de Lloydminster et de l'usine de valorisation NewGrade de Regina a fait ressortir certaines faiblesses fondamentales :

- l'absence d'un ensemble complet d'objectifs clairs et mesurables;
- une coordination insuffisante de la surveillance des retombées;
- des lacunes dans le suivi des recommandations et des engagements qui découlent de l'évaluation environnementale;
- des lacunes persistantes dans la mesure de l'efficacité;
- un rapport limité et de piètre qualité à l'intention du Parlement et du public dans la Partie III du Budget des dépenses.

Ces préoccupations ont leur importance, en raison de l'envergure, de la visibilité et de l'importance des mégaprojets actuels et des mégaprojets possibles dans l'avenir.

14.2 Il faut de toute évidence trouver des moyens de gérer plus efficacement l'intérêt fédéral dans des projets communs ou partagés qui engagent la participation de différents paliers de gouvernement et du secteur privé. Il est essentiel d'avoir des mesures appropriées de contrôle, y compris un suivi prudent, si l'on veut protéger les intérêts fédéraux. L'élaboration de politiques d'organisme central contribuerait à une meilleure gestion ministérielle et à une meilleure surveillance de l'investissement fédéral dans des coentreprises ou entreprises communes.

14.3 Le ministère de l'Énergie, des Mines et des Ressources doit mieux rendre compte des résultats, c'est-à-dire de ce que des mégaprojets ont permis ou non de réaliser avec l'argent des contribuables. Il ne suffit pas de simplement contrôler les dépenses financières et d'en rendre compte. Il est également nécessaire de rendre compte des résultats, afin de permettre un examen parlementaire et un examen public critiques des résultats des dépenses.

LA GESTION DES FORÊTS DES INDIENS

15.1 Le ministère des Affaires indiennes et du Nord canadien (MAINC) ne s'est pas entièrement acquitté de ses responsabilités légales en ce qui concerne les terres forestières des Indiens.

15.2 Le *Règlement sur le bois de construction des Indiens* établi par le MAINC pour qu'il s'acquitte de ces responsabilités est inapproprié et inapplicable.

15.3 Il faut le consentement des bandes pour pénétrer dans les réserves et pour délivrer des permis d'exploitation forestière, mais c'est la Couronne qui détient les terres des réserves. La gestion des forêts de la réserve requiert donc la collaboration des deux parties.

15.4 Le ministère et les conseils de bande n'ont pas l'information voulue pour prendre des décisions efficaces au sujet des terres forestières des Indiens.

15.5 Si elles étaient mieux gérées, les forêts des Indiens pourraient générer des avantages économiques et sociaux durables d'importance.

LA CONVENTION SUR L'INONDATION DES TERRES DU NORD DU MANITOBA

15.6 En vertu de la Convention sur l'inondation des terres du nord du Manitoba de 1977 (CITNM), les gouvernements du Canada et du Manitoba et Hydro–Manitoba ont convenu d'indemniser cinq bandes indiennes touchées par les effets négatifs des travaux d'aménagement hydroélectrique entrepris par Hydro–Manitoba.

15.7 D'après le ministère des Affaires indiennes et du Nord canadien, les effets négatifs comprenaient : l'inondation de quelque 2 134 kilomètres carrés de terres, y compris 67 kilomètres carrés de terres de réserves où vivent 10 000 Indiens inscrits.

15.8 C'est un processus de résolution de différends qui préside à la mise en oeuvre de la Convention sur l'inondation des terres du nord du Manitoba plutôt qu'un effort coordonné de collaboration de la part de toutes les parties. Ceci se fait non seulement au détriment des parties engagées dans la Convention, mais aussi au détriment des contribuables du Canada qui, en fin de compte, paient la facture.

15.9 On n'a pas tenu dûment compte de certaines considérations environnementales, même si le gouvernement fédéral savait qu'il existait à cet égard des dangers réels ou éventuels.

15.10 Le MAINC ainsi que d'autres ministères fédéraux ont dépensé plus de 115 millions de dollars en vertu de la Convention (la plus grande partie depuis 1988), mais ils n'ont pas en main les coûts totaux à ce jour, ni ne savent quels seront les coûts dans l'avenir. En vertu d'une proposition de 1990, le gouvernement fédéral verserait aux bandes une somme supplémentaire de 78 millions de dollars, ce qui ne comprend pas le financement habituel continu.

Le ministère de la Défense nationale

Grands projets d'immobilisations – Initiatives de développement industriel

16.1 Dans le cadre des grands projets d'immobilisations, l'optimisation des ressources vise trois objectifs majeurs : l'objectif premier et primordial consiste à satisfaire aux exigences opérationnelles de la manière la plus rentable qui soit; le deuxième est de promouvoir un développement industriel et régional rentable et viable; et le troisième comprend la réalisation des autres objectifs nationaux. Ce chapitre porte sur l'interaction des deux premiers objectifs.

16.2 Avant 1985, il était courant de chercher des mesures compensatoires dans les grands marchés de la défense. En 1985, un groupe de travail ministériel a conclu que ces mesures compensatoires étaient coûteuses et que l'on exagérait l'importance de leurs éventuelles retombées économiques pour le Canada. Dans son rapport, le groupe de travail a suggéré qu'on réévalue les politiques gouvernementales de manière à viser plutôt les avantages durables que de chercher à obtenir un maximum de compensations. Résultat, l'accent a porté par la suite sur les bénéfices directs.

16.3 La participation directe de l'industrie canadienne aux grands projets d'immobilisations risque tout au plus d'entraîner de faibles coûts additionnels dans les secteurs où elle est déjà concurrentielle. Souvent, par contre, la participation canadienne exige des investissements en matière de conception, d'infrastructure, de perfectionnement de la main-d'oeuvre ou autre, entraînant ainsi des coûts supplémentaires pour le Canada par rapport aux coûts demandés par les fournisseurs établis sur le marché étranger. Satisfaire les besoins d'approvisionnement tout à fait uniques, que ce soit au Canada ou à l'étranger, suppose une forme ou une autre d'investissement.

16.4 Nous avons examiné six grands projets de l'État relevant du ministère de la Défense nationale (grands projets d'immobilisations de plus de 100 millions de dollars) qui étaient en cours au début de notre vérification et dans le cadre desquels des marchés avaient été conclus et des initiatives de développement industriel étaient prévues, en tout ou en partie, en vertu de la politique gouvernementale en vigueur. Nous avons trouvé que les coûts découlant de ces initiatives étaient élevés, sans compter que celles-ci n'avaient généralement pas donné lieu à de nouvelles activités industrielles durables et concurrentielles sur les marchés intérieur et extérieur comme l'exige la politique gouvernementale actuelle. Nous avons également constaté dans certains cas que ces initiatives avaient eu des répercussions sur les exigences opérationnelles du ministère.

16.5 Nous recommandons alors que des mesures soient prises pour améliorer la planification stratégique dans ce domaine; fournir aux décideurs des analyses pertinentes des coûts et des avantages associés aux initiatives de développement industriel; et améliorer la présentation de rapports au Parlement.

Grands projets d'immobilisations – Lancement et mise en oeuvre des projets au ministère

17.1 Le chapitre précédent porte principalement sur l'incidence de certains facteurs externes sur les grands projets d'immobilisations du ministère de la Défense nationale dès les premières étapes des projets. Ce chapitre examine les systèmes, les politiques et les méthodes internes du ministère influant sur l'optimisation des ressources dans le cadre des grands projets d'immobilisations.

17.2 Nous avons constaté que le processus de Planification de la défense et de développement des Forces comporte essentiellement les mêmes lacunes que le processus de planification des politiques qu'il remplace et dont nous avons fait rapport en 1984. Dans sa forme actuelle, il n'offre toujours pas une assise suffisante pour tirer le meilleur parti du Système de gestion du Programme de la Défense. Aucun des projets retenus par échantillonnage n'était fondé sur les documents officiellement approuvés d'élaboration de décisions dans le processus de Planification de la défense et de développement des Forces et l'on n'avait, dans aucun cas, franchi toutes les étapes de ce processus comme le stipulent les documents officiels du ministère.

17.3 À notre avis, le Système de gestion du Programme de la Défense est inefficace, encombrant et, compte tenu des ressources qui y sont affectées, très coûteux. Il n'a tout simplement pas été appliqué et, à toutes fins pratiques, ne nous semblait pas réalisable. Ces lacunes, auxquelles s'ajoutent celles dont fait état le chapitre précédent et attribuables à des facteurs externes, compromettent grandement l'optimisation des ressources.

17.4 Pour améliorer le Système de gestion du Programme de la Défense, il faut au préalable mettre au point le processus de Planification de la défense et de développement des Forces.

17.5 Ni le document sur le Système de gestion du Programme de la Défense, ni aucun autre document officiel du ministère ne décrivent les méthodes de contrôle de programme visant à assurer la gestion au jour le jour des 550 grands projets d'immobilisations du ministère. Il ne semble y avoir aucun ordre des priorités pour la gamme complète des projets et, dans sa forme actuelle, le Système d'information du Programme des services de défense ne favorise en rien le contrôle des programmes.

17.6 La plupart des difficultés que nous avons observées — délais de livraison, escalade des coûts ou problèmes d'approvisionnement en équipement pour satisfaire aux exigences opérationnelles — étaient attribuables à des problèmes externes et internes qui se sont manifestés dès les premières étapes, lors du lancement du projet.

17.7 En 1988, notre rapport précisait que le ministère achetait et stockait des quantités excessives de pièces de rechange. Dans la présente vérification, nous avons trouvé que les prix payés étaient sensiblement plus chers que nécessaire.

Le ministère de la Défense nationale

La Réserve des Forces canadiennes

18.1 La Réserve des Forces canadiennes constitue un élément essentiel des forces armées. Ses dépenses s'élèvent actuellement à quelque 750 millions de dollars par année. D'ici l'an 2000, la Réserve formera 46 p. 100 des effectifs en personnel des Forces canadiennes. À la suite d'une récente réorientation, la Réserve est appelée à être revitalisée et à jouer un rôle plus important.

18.2 Notre vérification montre que la capacité militaire du système actuel de la Réserve est limitée. Le ministère de la Défense nationale a reconnu l'existence de nombreux problèmes fondamentaux sur lesquels il faut se pencher.

18.3 Le ministère doit remédier à bien des lacunes au chapitre de la planification. En particulier, il lui faudra définir les rôles et préciser les moyens les plus rentables de faire appel aux services des réservistes. Notre vérification nous pousse à conclure qu'en vertu de la formule actuelle, le ministère perd, dans l'ensemble, l'avantage financier qu'il serait censé retirer de la plus grande composante de la Réserve. Le ministère doit aussi élaborer des politiques qui lui garantiront un nombre suffisant de réservistes pour l'instruction et lors de situations d'urgence.

18.4 Pour la plupart, les méthodes actuelles de gestion des ressources humaines ne tiennent pas compte du fait que les réservistes sont des membres à temps partiel des Forces canadiennes. Les emplois et les normes touchant l'instruction et les promotions ne sont pas en harmonie avec les exigences opérationnelles, voire même, ces normes ne sont pas appliquées. Les systèmes sont en train d'être révisés, mais ils n'ont pas été conçus en fonction de la faible disponibilité des réservistes. Sauf quelques exceptions dignes de mention, la même observation vaut pour la reconnaissance des compétences acquises par les réservistes dans la vie civile.

18.5 Au chapitre des méthodes d'approvisionnement en fournitures, de l'équipement et des installations, nous avons repéré des problèmes qui soulignent eux aussi la nécessité de faire approuver pour la Réserve un plan réalisable. Les problèmes de financement compromettent la capacité de la Réserve et, dans bien des cas, il n'est pas facile de discerner le bien-fondé des projets.

18.6 Il faudrait nettement améliorer l'obligation de rendre compte du rendement de la Réserve auprès du Parlement et au sein du ministère.

18.7 Les Forces canadiennes reconnaissent que surmonter de telles difficultés sera probablement au nombre de ses plus grands défis au cours de la prochaine décennie. Afin de donner suite à bon nombre des questions soulevées lors de notre vérification, le ministère vient d'entreprendre de grands programmes de réorganisation, de gestion des ressources humaines et de modernisation de l'équipement.

19.1 La ***Loi sur les mesures spéciales d'importation*** **offre aux producteurs nationaux un cadre législatif pour contrebalancer le préjudice sensible que leur causent les marchandises sous–évaluées ou subventionnées provenant de l'étranger. Le ministère du Revenu national, Douanes et Accise est avant tout responsable des enquêtes sur le prétendu dumping ou l'octroi présumé de subventions causant un préjudice. Le Tribunal canadien du commerce extérieur mène des enquêtes et rend des conclusions en ce qui a trait au préjudice.**

19.2 **Le ministère a pris des mesures raisonnables quand il s'agit d'ouvrir des enquêtes et de déterminer s'il y a dumping. Nous avons relevé certains domaines où le ministère devrait partir d'une perspective plus large lorsqu'il étudie la question du préjudice pendant l'enquête, avant de rendre une décision provisoire. De plus, la procédure qui découle de la loi empêche le ministère de prendre en considération toute autre preuve de préjudice lorsqu'un cas est renvoyé pour obtenir l'avis du Tribunal au début du processus.**

19.3 **Les engagements offerts par les exportateurs ou les gouvernements étrangers peuvent constituer une solution de rechange moins coûteuse que le processus complet. Cependant, tout intéressé peut facilement s'opposer à un engagement et y faire mettre fin, rendant ainsi inutiles les négociations et les efforts antérieurs. En outre, il faut que le ministère contrôle de près les engagements pour déceler promptement l'inobservation de leurs modalités.**

19.4 **Le ministère a fait une étude d'évaluation en 1988 et s'est servi des résultats pour améliorer sa mise en oeuvre du programme. Le ministère des Finances, qui est responsable de la politique et de la législation, effectue une surveillance continue des mesures antidumping et compensatoires, mais il n'a pas fait d'évaluation officielle du programme depuis l'entrée en vigueur de la Loi en 1984. Selon nous, une telle évaluation est nécessaire pour déterminer si l'équilibre établi en 1984 entre les droits et les obligations est toujours valable dans le contexte commercial actuel, surtout à la lumière de l'Uruguay Round des Négociations commerciales multilatérales et de l'*****Accord de libre–échange entre le Canada et les États–Unis*****.**

Le ministère du Revenu national, Douanes et Accise

Taxe sur les produits et services – Inscription et sous-activités connexes

20.1 Ne disposant que de 20 mois à partir de l'annonce du budget, et malgré l'adoption du texte législatif le 17 décembre 1990 seulement, le ministère a tout de même réussi à mettre en place, pour le 1er janvier 1991, les systèmes et les procédures nécessaires pour commencer l'application de la taxe sur les produits et services (TPS).

20.2 Le ministère a atteint son objectif de 1,6 million d'inscrits pour avril 1991. Nous avons cependant observé que bon nombre d'autres mesures de suivi et de tenue des comptes demeurent à adopter dans le programme d'inscription, actuellement limité dans sa capacité de trouver de nouveaux inscrits. En outre, de nombreux comptes ont été fermés sans les pièces justificatives nécessaires, et l'exigence visant certaines données pertinentes a été éliminée du modèle initial de formule d'inscription.

20.3 Le ministère avait instauré un programme complet d'information du public avant que la taxe n'entre en vigueur. Les demandes de renseignements par téléphone ont été très nombreuses en 1991-1992; certaines des ressources du programme d'inscription et d'autres activités d'observation ont dû être redistribuées. En ce qui concerne les réponses aux demandes écrites de renseignements, le ministère doit réévaluer le délai d'exécution à viser, établir l'ordre de priorité des demandes, explorer des façons de mieux communiquer les modifications aux utilisateurs et travailler de concert avec le ministère des Finances pour recommander la promulgation opportune des modifications législatives proposées.

20.4 Presque 1,6 million des 1,7 million d'inscrits sont des petites entreprises qui produisent des déclarations trimestrielles. Même si le texte législatif prévoit certaines simplifications, peu de petites entreprises les ont choisies. Le ministère a commencé à se pencher sur certains aspects en vue de simplifier l'application de la taxe pour le secteur des petites entreprises et pour lui-même. Nous croyons qu'une simplification plus poussée pourrait accroître grandement l'efficience du système, pour les inscrits comme pour le ministère.

20.5 Les rapports sur les frais de démarrage de la TPS ont été fragmentés. Même si un grand nombre de ministères et d'organismes ont participé à la mise en application, les coûts globaux n'ont pas été consolidés et présentés au Parlement. De plus, la reddition de comptes relative à l'élaboration du système automatisé de la TPS, un grand projet de l'État, doit être améliorée.

Règlement des différends concernant les cotisations d'impôt sur le revenu

21.1 Les contribuables qui croient avoir été traités injustement ont le droit de produire un avis d'opposition et de déclencher ainsi un examen, qui sera effectué par des agents des appels de Revenu national, Impôt (RNI). Les contribuables qui ne sont pas satisfaits des résultats de cet examen peuvent interjeter appel auprès des tribunaux.

21.2 La Direction générale des appels de Revenu national, Impôt s'est engagée à faire en sorte que les différends avec les contribuables soient résolus avec impartialité et dans les meilleurs délais.

21.3 Les principes généraux et l'organisation de la Direction générale des appels, ainsi que la formation dispensée par celle-ci, visent à engendrer l'impartialité. La direction générale dispose de certains indicateurs de la mesure dans laquelle elle atteint l'équité visée, mais elle cherche des indicateurs supplémentaires. Par exemple, elle s'apprête à demander aux contribuables, par un sondage, la façon dont ils voient les choses.

21.4 La Direction générale des appels a grossi parce que sa charge de travail augmentait et que les exigences législatives devenaient plus astreignantes. Malgré l'augmentation de ses ressources, elle prend plus de temps qu'auparavant pour résoudre les cas : en moyenne trois mois pour les cas simples et plus de 14 mois pour les cas compliqués.

21.5 Revenu national, Impôt devrait mettre à la disposition des parlementaires plus de renseignements concernant le rendement dans le processus de règlement des différends.

La Gendarmerie royale du Canada

Le service de police provincial et municipal

22.1 Une association de longue date. Depuis des décennies, la Gendarmerie royale du Canada (GRC) assure, à la suite d'ententes contractuelles, les services de police provinciaux, territoriaux et municipaux dans huit provinces (sauf en Ontario et au Québec), dans les deux territoires et dans 191 municipalités. Cette association, qui a résisté au temps, a procuré à toutes les parties d'importants avantages.

22.2 Efficience des opérations. La GRC pourrait améliorer son efficience si un plus grand nombre de ses détachements mettaient en oeuvre une «stratégie d'intervention différentielle» et adoptaient une organisation par relais plus efficiente. Il lui faut également recourir davantage à la technologie en place et rendre plus efficiente la rédaction de ses rapports. Elle devrait, en outre, améliorer ses pratiques de mesure du rendement et remédier aux problèmes que posent ses systèmes d'information de gestion.

22.3 Du nouveau — la police communautaire. Ces dernières années, la philosophie policière a évolué. On insiste davantage sur la consultation de la collectivité et sur la recherche de solutions. La GRC a été en mesure d'accomplir des progrès, sous un certain nombre d'aspects, en matière de police communautaire (aussi appelée police sociopréventive), par exemple, en commençant à engager des membres des minorités visibles et en créant une Direction de la police communautaire et des autochtones. On constate toutefois certains retards. La Gendarmerie n'a pas élaboré de lignes directrices qui viseraient à hausser la participation de la collectivité et à améliorer ses opérations policières locales. Elle en est encore à adapter ses règles et ses pratiques de recrutement, de formation, etc. pour répondre aux besoins qui découlent de la nouvelle philosophie.

22.4 Partage des coûts. Le gouvernement fédéral n'a jamais recouvré le coût total de ses services de police à contrat, parce qu'il croit qu'il tire certains avantages de l'entente. Le contrat de 1992 ajoute certains éléments à la base de coûts négociée, laquelle sert à déterminer la quote–part des provinces et celle des municipalités. Grâce à ces ajouts, la nouvelle base de coûts négociée reflète mieux le coût réel qu'assume le gouvernement fédéral. Nous estimons toutefois qu'il existe, entre cette nouvelle base et le coût réel, un écart de 100 à 150 millions de dollars. Nous nous préoccupons du fait que ces chiffres réels ne soient pas clairement expliqués au Parlement. Nous croyons que, lorsque viendra le moment d'examiner le contrat dans cinq ans, le gouvernement fédéral devrait chercher à négocier en fonction d'une base de coûts qui comprend tout ce qui constitue le coût réel.

23.1 De tous les éléments qui influent sur l'efficacité globale de la Gendarmerie, la gestion des ressources humaines est le plus déterminant. Pour bien servir la population canadienne, la Gendarmerie doit absolument pouvoir compter sur des personnes compétentes, motivées et très intègres. Les ressources humaines représentent environ 80 p. 100 de son budget de fonctionnement, qui s'élève à 1,8 milliard de dollars.

23.2 La GRC exerce ses activités dans un environnement en constante évolution qui appelle de plus en plus un réexamen de la manière dont elle conduit ses opérations et fournit ses services. Reconnaissant la nécessité d'effectuer des changements, la Gendarmerie a amorcé un ensemble d'initiatives d'importance. L'une des principales initiatives est le renouvellement profond de ses systèmes et de ses méthodes de gestion des ressources humaines. Des projets sont en cours dans des domaines clés comme le recrutement, la formation, la gestion de carrière et la santé des membres.

23.3 Au cours de notre vérification, nous avons relevé plusieurs aspects à améliorer : la planification des ressources humaines, la sélection et la formation des recrues, la formation de recyclage et la gestion de carrière. Comme on l'a mentionné plus haut, la Gendarmerie avait déjà entrepris d'améliorer bon nombre de ces points. Étant donné que des initiatives sont en cours et que leur succès importe grandement, nous surveillerons les progrès accomplis dans ces domaines.

La protection civile au gouvernement fédéral

24.1 Nous avons examiné la situation de la protection civile au gouvernement fédéral. Notre premier rapport au Parlement à ce sujet date de 1987 et, en 1990, le Comité permanent des comptes publics nous demandait de faire état des progrès accomplis dans ce domaine.

24.2 En règle générale, les problèmes de longue date relatifs à la planification des mesures d'urgence au gouvernement fédéral ne font pas l'objet d'un suivi dans des délais raisonnables. Par exemple :

- Cinq ans après que nous avons soulevé la question, la partie générale (partie I) du Plan national de soutien en cas de tremblement de terre (PNSTT), qui pose un cadre en vue de la planification ultérieure, est près d'être achevée. Toutefois, les travaux en vue de la partie II, soit les plans portant sur la fonction de soutien exercée par les ministères en cas d'urgence, sont toujours en cours.
- Le ministère de l'Environnement apprenait au Cabinet, en juin 1991, que la plupart des recommandations importantes présentées en 1986 dans le document intitulé «Étude des répercussions de Bhopal» étaient restées lettre morte, quoique certaines d'entre elles aient été mises en oeuvre, comme la recommandation d'établir le Conseil canadien des accidents industriels majeurs.
- Un examen effectué en 1986 de l'accident survenu à Tchernobyl a mené à la recommandation d'importantes améliorations à apporter au plan d'intervention du gouvernement fédéral en cas d'urgence nucléaire. La majorité de ces améliorations n'ont pas été mises en oeuvre ou en sont encore aux premières étapes d'élaboration. La révision du plan devrait se situer au premier rang des priorités.
- Il reste à clarifier les attributions des ministères responsables de la planification des mesures d'urgence et à améliorer la coordination interministérielle.

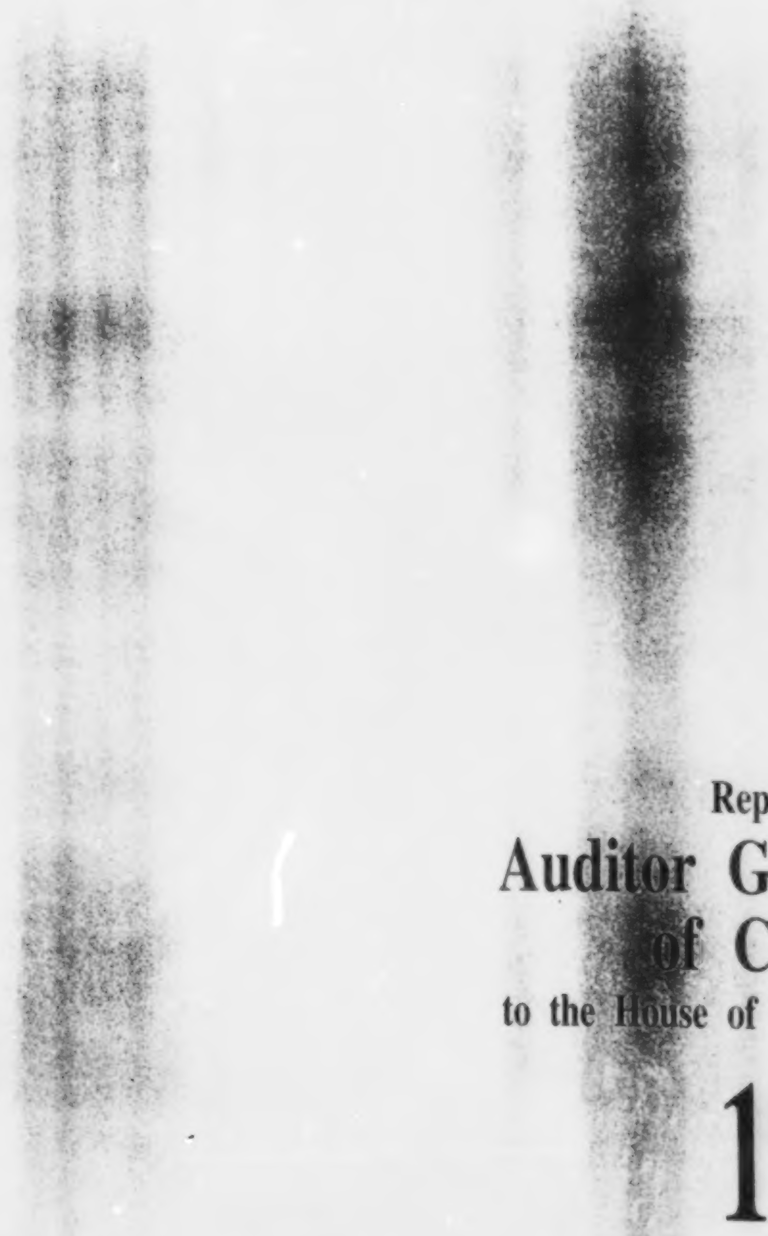
24.3 Nous nous inquiétons de ce que le retard mis à élaborer des plans coordonnés pour les cas d'urgences majeures diminue la rapidité de l'intervention, un facteur d'une importance capitale pour la protection de la vie humaine et des biens.

24.4 À notre avis, ce retard est attribuable à plusieurs facteurs, dont des différends entre les ministères concernant le partage des compétences, l'affectation de ressources à d'autres questions prioritaires, la complexité de la coordination des mesures d'urgence avec les provinces et le fait qu'on ne se sente pas pressé d'agir, ce qui s'explique peut-être par le fait que le Canada n'a pas connu de catastrophe dans un passé proche.

24.5 L'information fournie au Parlement sur l'état de préparation à une urgence civile, à l'échelle du gouvernement, comporte des lacunes. À défaut de l'adoption d'une méthode de rechange, le Parlement pourrait pratiquement ne recevoir aucun renseignement sur cette question à la suite des propositions faites par le gouvernement dans le cadre du budget, de soustraire les ministères à l'obligation de dresser un rapport annuel sur la protection civile.

Report of the
Auditor General of Canada
to the House of Commons

1992



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AUDITOR GENERAL OF CANADA
VÉRIFICATEUR GÉNÉRAL DU CANADA

To The Honourable the Speaker of the House of Commons:

I have the honour to transmit herewith my Report to the House of Commons for the fiscal year ended 31 March 1992, to be laid before the House in accordance with the provisions of section 7(3) of the Auditor General Act.

L. Denis Desautels.

L. Denis Desautels, FCA
Auditor General of Canada

OTTAWA, 24 November 1992

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Report of the Auditor General to the House of Commons for 1992

Introduction

Report of the Auditor General to the House of Commons for 1992

Introduction

The principal functions and responsibilities of the Auditor General of Canada are set out in the Auditor General Act. My responsibilities in respect to those Crown corporations for which I have been appointed auditor are set out in the Financial Administration Act. The Auditor General Act is included as Appendix A to this report and the relevant sections of the Financial Administration Act as Appendix B.

The financial statements of the Government of Canada for the fiscal year ended 31 March 1992, which have been prepared by the Receiver General for Canada in accordance with the provisions of section 64 of the Financial Administration Act and appear in Volume I of the Public Accounts of Canada, have been examined by me as required by section 6 of the Auditor General Act.

In compliance with section 7 of the Auditor General Act, my report for 1992 is presented herewith.

As auditor of the accounts of Canada, including those relating to the Consolidated Revenue Fund, I conducted such examinations and inquiries as I considered necessary to enable me to report as required by the Auditor General Act.

With respect to the matters reported, departments, agencies, and the Privy Council Office provided my Office with the information and explanations required to date, including Cabinet documents.

Chapter 1

Matters of Special Importance and Interest

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Matters of Special Importance and Interest

Main Points

1.1 Chapter 1 focusses on issues that I believe are fundamental to achieving accountability in government and to enhancing our national institutions.

1.2 **Information for Parliament.** The Office recognizes that Parliament needs appropriate information from government departments and agencies to fulfil its role in responsible government. What information is relevant? This year's Report gives practical recommendations on this issue.

1.3 **Stewardship of the national debt.** I find that there is an ever–growing concern among taxpayers about the federal deficit and debt. We need to consider ways of improving the government's financial disclosure to help Canadians better understand and assess the significance of the deficit and debt.

1.4 **Truth in budgeting.** There is also a need to recognize and make visible, on a timely basis, any costs that may arise from federal credit programs such as loan guarantees.

1.5 **First Nations.** In the 1991 Report and again this year, the Office has identified the need to clarify the financial relationship between the government and First Nations. What should be the government's accountability for funding provided to First Nations?

1.6 **Protection of the environment.** Implementation of sustainable development requires integration and balancing of economic and environmental factors in all aspects of government decision making. What role should departments, agencies, regulators, my Office and other federal government auditors play in implementing this concept?

1.7 **Public service reform.** Taxpayers may well ask, "Will the government's current management reform initiative result in higher productivity, appropriate levels of service, higher morale, and greater cost–effectiveness?" In this chapter, I comment on the progress of the reform initiative.

1.8 **Information technology.** Government operations can be made more productive by the appropriate selection and application of new information technologies. However, ways need to be found to better manage the risks inherent in developing large computer systems.

Introduction

Putting the annual Report in context

1.9 For several years now, Canada has experienced slow economic growth, business closures and high unemployment. Canada is not unique: other industrialized nations have experienced similar downturns. As Auditor General, and as a Canadian, I am deeply concerned about the economic challenges Canada faces both nationally and internationally, and about their impact on individual Canadians.

1.10 Canadians are very worried about the impact of annual deficits and the accumulated debt on their standard of living and that of future generations of Canadians. At the same time, they expect the government to provide more, not fewer, services. The government's dilemma, which is not really new, is that its financial resources are constrained, while demands on those resources increase. In this Report, my Office recommends numerous ways to improve government operations. In doing this, I am continuously motivated by the desire to see the credibility of our national institutions strengthened.

1.11 A common thread in Chapter 1 is the duties and obligations of stewardship. The obligations of stewardship change as modern government becomes more complex. We rely on government to manage complex economic and social issues — environmental protection, regulation of industries, tariff and trade agreements, for example — that affect our lives in far–reaching ways. A serious concern is whether Parliament is provided with the information it needs to effectively monitor the government's stewardship of public resources.

Departments Need to Tell Their Story in Clear Global Terms

1.12 For responsible government to work, Parliament needs to receive information from federal departments and agencies on how well they have discharged their stewardship roles. The obvious question is "what information is needed and how should it be provided?"

There is a need for reporting that reflects the broader duties and obligations of government

1.13 Parliamentarians should be provided with the information they need, information that is relevant, reliable and understandable. They need this information to ask straightforward, probing questions that test the competency of departments and agencies in fulfilling the purposes for which Parliament has voted them funds. Chapter 6, Information for Parliament — Departmental Reporting, provides a historical perspective on this issue and explains how Parliament holds the executive to account by examination and critical questioning.

1.14 Government is in the complex business of fostering the public good and, in doing so, managing its substantial resources judiciously; the instruments it uses to achieve this are varied. Reporting that focusses on annual spending and compliance with authority does not fully reflect the broader duties and obligations to preserve and foster the government enterprise. The Office recommends broader–based departmental reporting that is flexible enough to accommodate the sometimes diverse nature of the organization's activities. Such reporting would answer the following four questions:

- **What are the department's missions and lines of business?**

The government's dilemma is that its financial resources are constrained, while demands on those resources increase.

Parliamentarians need this information to ask straightforward, probing questions.

- How does the department carry out its lines of business to achieve its missions?
- What are the department's strategic objectives for realizing its missions, and its plans for managing the public resources under its control?
- How well did the department meet its objectives, and how much did it cost?

There is a need to distinguish between the information that managers need to manage and the information that MPs need to hold the government to account.

1.15 Good stewardship reporting calls for clarifying and articulating a department's purpose and determining measurable goals. To tell Parliament what it needs to know, a report must be more than a summation of departmental expenditures, statistics and other details of activities. It must reflect a department's view of itself: its missions, its strategic plans and its assessment of how well it is meeting objectives.

It's time to put accountability into operation

1.16 There are several challenges to be met in changing to broader–based reporting. First, there is increasing complexity and breadth in government activities; many activities are inherently difficult to measure and describe. Second, in a political context, departments tend to report good news, not problems or failures. Third, the necessary information may be unavailable in a department or agency. Fourth, there is a need to distinguish between the information that managers need to manage and the information that MPs need to hold the government to account.

Evaluations too often are silent on the more searching questions about a program's continued relevance, program alternatives and the policy that gave rise to the program.

1.17 Finally, and perhaps most important, there is still a need to put accountability into operation. By this, I mean the need for government departments to move beyond the slogans, to define more precisely what goals and tangible results a department is accountable for achieving and to actually tell their story in clear and global terms.

1.18 Chapter 6 offers suggestions for changing the reporting format, for developing a vision of departmental reporting to Parliament. Future chapters will focus on appropriate content for this approach to reporting.

Parliament Should Get Information on Results

Parliament and Canadians want to know: are government programs making a difference?

1.19 Regularly reported indicators of results — for example, how many of the people trained at public expense find jobs — provide Parliament and other Canadians with initial indications of whether programs are achieving results. But, on their own, they do not provide answers to the kinds of searching questions that could be of concern to many: was it the program that produced those results, or would people have found jobs anyway? Does the government need to continue the program? Can better results be achieved, at less cost? Answering these questions requires relevant, credible and objective information. One way to get this information is by in–depth study — commonly referred to as program evaluation. Government departments are expected to evaluate their programs, and to report the findings in summary form to Parliament.

1.20 Chapters in this year's Report demonstrate that some departments are doing a good job of examining operational issues in their evaluations. But too often they are silent on the more searching questions about a program's continued relevance, program alternatives and the policy that gave rise to the program.

Why do evaluations often miss the basic questions that interest Parliament?

1.21 In a discussion paper published by my Office, entitled "Reflections on Administrative Reform in the

Government of Canada, 1962–1991", Mr. A.W. Johnson, a former senior public servant, examines the history of program evaluation. After reviewing the past thirty years, Mr. Johnson concludes that evaluation has not yet emerged from its experimental phase. He feels that evaluation has yet to be perfected — that there are legitimate technical difficulties that must be overcome, program by program. But Mr. Johnson questions whether there is not a more fundamental problem with the present departmental evaluation regime: its compatibility with the system of government into which it is being implanted.

1.22 Under the current approach to evaluation, deputy ministers of each department are responsible for evaluating their own programs. There have been very few evaluations carried out by central agencies. Departmental evaluators are expected to serve the department's need for policy and operational information and, at the same time, the different needs of central agencies and Parliament.

1.23 Perhaps we expect too much of departmental evaluators. Is it reasonable to expect that they will serve not only the information needs of their departments, but also those of central agencies, parliamentarians and taxpayers? This is a tall order. First, each group needs information at a different level of detail, and for different reasons. Departments need evaluations of their operations because they are responsible for managing programs. Parliamentarians' interests vary widely but tend toward broader policy questions, not the day–to–day operational matters that are of most interest to departments.

1.24 Second, it may be naive to think evaluators will arrive at, and their ministers report to Parliament, evaluation findings that can be used to embarrass the government. There isn't much point in expecting reporting that would contradict the reality of a deputy minister's loyalty to the minister. This is a critical issue that will be explored in greater depth in our upcoming government–wide audit of effectiveness measurement and reporting.

There isn't much point in expecting reporting that would contradict the reality of a deputy minister's loyalty to the minister.

Fair Presentation and Stewardship of the Public Debt

Widespread concern about the deficit

1.25 One of my responsibilities is to examine and report on the government's financial statements. In my Report last year I referred to widespread concern about our annual deficit and accumulated debt, two significant numbers shown in these statements. I suggested that the government prepare and publish a "scorecard" to inform Canadians how their government has performed in carrying out its action plan for deficit reduction. At the time of writing this Report, the government has given no indication that it intends to publish such a "scorecard". I remain convinced that it should.

1.26 As well, I believe there is a need for further measures. And so, in my second Report to Parliament, I offer another suggestion — that we consider ways of improving the government's financial disclosure to help Canadians better understand and assess the significance of the annual deficit and accumulated debt.

1.27 In truth, few Canadians show much interest in the government's financial statements. This is hardly surprising — financial statements bring to mind images of endless numbers and unfamiliar terms understandable only to accountants. Yet assessing information on the country's financial condition is too important to be left only to technical experts.

Information on the country's financial condition is too important to be left only to technical experts.

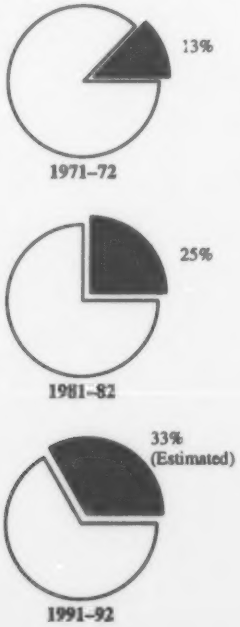
1.28 I believe that the government's financial statements should inform Canadians about the government's financial condition in terms

The significance of public debt lies in much more than its current level.

The larger the interest bite, the more stringent are the limitations on the government's spending choices and on its ability to cope with unforeseen emergencies.

Exhibit 1.1

The Interest Bite
(Public Debt Charges as a Percentage of Total Budgetary Revenue)



they can understand, and should provide an early warning when deficits and debt may cause difficulties down the road. But better information alone is not enough. There must also be a forum for rational discussion of the issues.

How do we know how much debt we can afford?

1.29 Countries must organize their spending, taxing, and borrowing policies to conform to their limitations. But assessing a country's financial condition is complicated by considerations that those of us who are not economists often find difficult to understand. One of the complexities in assessing a government's financial condition is the pernicious interaction between annual deficits and accumulated debt. As is well known, our recent annual deficits (and those projected by the government for the next few years) would be surpluses were it not for the cost of servicing the debt we have accumulated in the past. Debt service not only turns an operating surplus into a budgetary deficit, but also increases the amount of the public debt and, therefore, the next year's debt service charges.

1.30 The significance of public debt lies in much more than its current level. It lies in the ability of the government to generate sufficient revenues to bear the debt service costs while, at the same time, providing a level of services that is consistent with the wishes of Canadians. If Canada's public debt and associated financing charges were small, these issues would not have to be faced. Now that the debt amounts to more than $400 billion, and annual interest costs to more than $40 billion, we need to understand much better the implications of debt and deficits. I see the need for information of two kinds to help clarify the government's financial statements, as they relate to deficits and debt: easily understandable measures and analysis of our financial condition, and projections of these measures into the future. Looking to the future is an unavoidable requirement for fairly assessing the present.

The need for simple measures that Canadians can understand

1.31 While I recognize that the issues surrounding the size and significance of public debt are complex, I think that, if we are to engage in any kind of meaningful debate on the subject, we will have to find simple indicators that are useful in understanding Canada's financial condition. For example, is there some indicator analogous to the credit limit test a mortgage lender applies to individuals?

1.32 Last year I commented on the "crowding–out" effect, where a greater proportion of taxes is consumed by debt servicing, with less available for services to taxpayers. One way to measure this effect is what might be called the interest bite, or the proportion of our taxes that is consumed by servicing past debt. The larger the interest bite, the more stringent are the limitations on the government's spending choices and on its ability to cope with unforeseen emergencies. As illustrated in Exhibit 1.1, in the last two decades that interest bite has almost tripled, growing from 13 percent to 33 percent. It is evident that the interest bite cannot be allowed to rise indefinitely.

1.33 The government's forecast calls for the interest bite to be reduced from its present level of 33 percent to 25 percent by 1996–97. I do not express an opinion on the need for or the proposed rate of interest bite reduction. This is a matter of policy. Protracted delay or precipitous haste in such reduction could, alike, conceivably damage the economy. The appropriate direction and speed of adjustment of the interest bite is for the government and Parliament to decide.

1.34 My concern is simply that the readers of Canada's financial statements need to understand more about the debt and deficits. Although I believe a simple and understandable indicator would be helpful in focussing public attention, I also recognize that any one indicator by itself may be too simplistic. The proper level of government activity and of public debt is a complex issue with economic, ideological, and political dimensions. But information that is too complex will not assist most readers. The proper balance between completeness and understandability needs to be studied.

The need for a long time horizon

1.35 In addition to the need for meaningful indicators, there is a need for the public to have information on the long–term implications of public debt. For example, how far we can deviate from the government's deficit reduction plan and still be financially secure? Would we be able to cope with an unexpected emergency, and still leave a financially sound country to our children?

1.36 To answer such questions, I believe it is necessary to look beyond a traditional five–year horizon and, indeed, perhaps to look as far ahead as thirty years, as the U.S. General Accounting Office did in a recent study:

> "We [the General Accounting Office] conclude that the one–year–at–a–time focus of budgeting has failed to serve the nation's needs. To build the foundation for a more productive nation in the future, it is essential that the budget process adopt a more future–oriented focus...".

Why might it be necessary to look so far ahead? There are two answers. The first arises from the insidiousness of gradualism; the second, from the arithmetic of compound interest.

1.37 **The insidiousness of gradualism and the arithmetic of compound interest.** We have become accustomed to deficits in the range of $30 billion. Gradual increases in a government's accumulated debt may not appear, to the average citizen, as urgent as some immediate demand for increased services or lower taxes. This is the insidiousness of gradualism: discomfort increases so slowly we don't notice it. Short–term forecasts don't show the long–term cumulative effect of these gradual changes. I have a nagging concern that they may not give us the early warning signals that we need to make rational choices.

1.38 As well, there is the arithmetic of compound interest. Early growth is gentle, but may become dramatic as interest is paid on interest. There is an old French riddle that goes like this: If a lily pond contains a single leaf, and each day the number of leaves doubles — two leaves the second day, four the third day, eight the fourth and so on — and if the pond is completely covered on the thirtieth day, at what point is it merely half covered? The answer, of course, is on the twenty–ninth day. But it's not immediately obvious. It's difficult to get very concerned in the early days of the month. The urgency of the situation is not evident until it's probably too late to do anything. That's why we need future–oriented projections warning us of the consequences of our actions, even before they are apparent in the annual historical financial statements or in a short–term forecast.

1.39 **Is it practical to make meaningful long–term forecasts?** Probably not. But it may be possible to make meaningful long–term *projections* of present trends. There is a major difference. A *forecast* tries to foresee the future — and we all know that is hazardous, particularly over the long term. But a *projection* merely asks: "If we keep on doing what we're doing today, will the results be affordable?" If so, our present trends are sustainable, as far as we can tell. If not, we can change the course we are on.

We have become accustomed to deficits in the range of $30 billion.

1.40 And multiple projections can tell us the effects of alternative assumptions or events — in other words, our boundaries of affordability. It is like driving a car down a winding road we have never travelled. Merely because we can't see around the next bend doesn't mean we focus only on the next few feet. We look ahead as far as we can. And we look to both sides to check how far we are from the edge of the road. We also check in the rear–view mirror. So, I think, should a country driving into the future. Financial sustainability, like steering, requires us to look ahead, not only to assess where we are going but also to assess our vulnerability to unforeseen events and changes in conditions.

A forum for rational discussion

1.41 The reality is that governments alone do not initiate deficits; international forces beyond our control and the needs and demands of the electorate also contribute to deficits. We give our stewards the difficult task of representing our interests while, at the same time, arbitrating our demands and trying to limit those demands that could impair the economic well–being of future generations. To help Canadians understand the difficult choices that have to be made, it seems to me that easily understood financial indicators and future–oriented information are absolutely necessary. But information by itself, without a forum or a vehicle for discussing it rationally, is simply not enough. There is a need today for a full and frank discussion about deficits, debt and related public policy choices such as the role of government in society.

There is a need today for a full and frank discussion about deficits, debt and related public policy choices.

The need for a study

1.42 I feel so strongly about these issues that I think a study is needed that focusses on them. The kind of study I have in mind would focus on identifying meaningful indicators and information that would put the public debt and deficit in context. It would also explore ways of dealing with the inherent limitations of shorter–term projections in providing an early warning about threats to long–term financial well–being. Finally, it would examine ways to encourage, within the parliamentary structure, the kind of meaningful debate that Canadians ought to have about deficits and debt.

The Need for an Early Warning System for Government Credit Programs

Truth in budgeting: making costs visible earlier

1.43 The phrase "truth in budgeting" has become popular in government circles in the United States as a way of expressing the need to make costs of credit programs visible earlier. Applied to Canada, this concept means that costs associated with credit programs — such as loan guarantees for student loans and energy megaprojects, and loans to other nations — should be recognized in the accounts and the national budget as soon as a potential loss can be estimated, rather than when the borrower defaults. This concept is discussed in several chapters in this year's Report.

1.44 These matters are of interest to parliamentarians and other Canadians. They touch on topics in the news, like the financing of the Hibernia oilfield off the coast of Newfoundland and the Westray coal mine in Nova Scotia, and loans to former Soviet republics. Billions of dollars are involved. These credit programs expose the government to a risk of loss, and there is a need to improve the accounting and reporting to make the related costs more visible earlier. Loan guarantees provide a good illustration of my concerns.

1.45 There is an inherent risk that loan guarantees are viewed as "free goods". Why are loan guarantees considered "free goods"? Past and present practices amount to two–step spending. For example, if the government gives a loan guarantee for $500 million, Parliament may be asked to approve a nominal $1 vote. Parliamentarians know from the wording of the vote that there is a maximum of $500 million involved. But the national budget and accounts of that and subsequent years do not include an estimate of the potential cost of the guarantee. In later years, if the borrower defaulted on the loan, the government would pay the lender up to $500 million and the amount would be reported in the deficit of that year. A key accounting question is "when should the risk of loss be recognized?"

1.46 **The risk of issuing a blank cheque.** I would expect the government to annually estimate the risk of loss associated with new and existing loan guarantees, and to recognize these expected costs in its national budget and financial statements. The government is not now doing this.

1.47 This is more than an accounting issue. The issue is one of making full and frank disclosure of risk when seeking parliamentary approval, and ensuring the proper discipline within government when considering requests for loan guarantees. Truth in budgeting would heighten answerability for costs, placing more of the onus squarely on the shoulders of government decision makers.

Emphasizing substance over form

1.48 The Government of Canada has many dealings involving financial support to other nations, usually in the developing world. Canada makes loans (called "sovereign" loans) to other nations when, for example, the Canadian Wheat Board sells grain on credit and when the Export Development Corporation lends money to finance Canadian exports. Canada also participates in international financial institutions, such as the World Bank and regional development banks. Canada's involvement with regional development banks is significant and growing. In total, Canada's cumulative financial assistance to the three major regional development banks, by way of funding and guarantees, has risen from $2.6 billion in 1983 to $6.2 billion in 1991.

1.49 My concern in these financial arrangements is that, too often, form hides substance. The government maintains official positions that only mask what is truly going on.

1.50 Sovereign loans provide a good example. The government's policy is to assume that sovereign loans are all eventually collectable and to recognize a loss on sovereign loans only if a nation formally repudiates what it owes, or if the debt is forgiven. In my view, this is far too late. If a sovereign loan falls into arrears and is rescheduled, the reality is that there is a substantial risk that amounts owing to the government will not be repaid.

1.51 In the 1989 Report the Office raised this same issue. The government continues to maintain that such loans — even to the most severely indebted nations — will be fully collected. The impression given is that these are assets worth their original value. Canadian commercial banks and international bodies, such as the World Bank, have come to recognize in their accounts that some indebted nations may not be able to repay. In doing so, they are simply recognizing reality.

What Is the Government's Accountability for Funding Provided to First Nations?

1.52 In recent rounds of constitutional reform, the issue of natives' inherent right to self-government was discussed. Over the coming years the government and the First Nations may be moving toward a new form of partnership. This may provide an opportunity to address a long-standing dilemma.

Past and present practices amount to two-step spending.

Truth in budgeting would heighten answerability for costs.

The government maintains official positions that only mask what is truly going on.

This long–standing dilemma needs to be resolved

1.53 Since 1965 there has been a trend toward the transfer or devolution of programs to Indian bands. Under current legislation, the Minister retains ultimate accountability to Parliament for the way public funds are spent and for the results they produce. But devolution means that the Department delegates decision making to bands. The Department's dilemma is that it retains responsibility for decisions over which it has limited control.

The Department's dilemma is that it retains responsibility for decisions over which it has limited control.

1.54 Last year's Report stressed the need to resolve the long–standing dilemma of reconciling the Department's accountability to Parliament with the funding arrangements under the devolution process. This issue is important in the current funding relationships with First Nations and may become even more important to funding arrangements in the future.

1.55 I am concerned that this dilemma remains unresolved. I am also disturbed by the letters and calls that came to my Office over the past year. Individual band members have related to me their concerns about the lack of means to effectively raise and resolve individual grievances or complaints against band decisions. The issue that these letters and calls raise is the form of accountability of band leadership to its members. There is a link between this accountability relationship and the accountability that I am concerned with — the relationship between the Department and Parliament.

1.56 At the present time, the Department is accountable for ensuring that the funds voted by Parliament are used for the purposes intended and with due regard to economy, efficiency and effectiveness. The Office recommended in 1991 that the Department improve its accountability framework under existing funding arrangements to require, as a minimum, timely activity and financial reports from bands and evaluation of the quality and level of services provided to band members.

1.57 The government needs to address the fundamental question of its stewardship over the use of taxpayers' money. At the heart of this issue is the changing role of the Department and the need to clarify expectations about its obligation to account for the use of funds by bands. I recognize that this is a difficult challenge that will take some considerable effort to resolve. Nevertheless, it is essential that it be addressed.

Clarifying Roles in Environmental Stewardship

1.58 Canada's Green Plan for a Healthy Environment is the focus of the federal government's environmental agenda for the next several years. Given the importance of implementing the Green Plan, I have three concerns. First is the need to clarify the roles of those responsible for carrying out environmental programs, including implementation of the Green Plan. Second is the need for environmental benchmarks, and reports that measure progress against these benchmarks. Third is the importance of audit and the environmental assessment process in environmental stewardship.

Partnership is a prerequisite for a better environment

1.59 Past annual Reports have highlighted the challenges of co–ordinating the activities of various departments to achieve common governmental objectives, in areas such as protection of the environment, drug interdiction and immigration. The 1990 chapter on the Department of Environment noted that, in the federal government alone, some 24 departments have responsibilities relating to more than 50 Acts with environmental implications. In addition, these departments often must act in conjunction with provincial governments, other countries, industry, and independent environmental organizations. Implementation of the Green Plan will require a high degree of co-ordination among all these groups.

1.60 If these partnerships are to be truly successful, it is essential that there be a clear understanding of the roles, responsibilities and accountabilities of each partner. Each should forthrightly indicate what it plans to achieve, the resources it needs and when, and how its success or failure will be measured. This will help eliminate unnecessary and costly duplication of effort, minimize the chance that significant issues will fall through jurisdictional cracks, and provide a basis for the public to hold the partners accountable, not only for the resources they spend on environmental objectives but also for the results they achieve.

Is the government making progress in environmental protection?

1.61 This question is important to all Canadians. To answer it, the government and its partners will have to continue to work at developing indicators against which progress can be measured. This is not an easy task. There are gaps in environmental data and the complex relationships between health of the environment and human activity are not fully understood. As a result, it is sometimes difficult to define acceptable standards of environmental quality. The first step in measuring performance is to establish clearly defined objectives, goals and time frames for environmental programs. There must be complete, clear, concise, honest and accurate reporting of results achieved against proposed targets, if Canadians are to be able to judge the success or failure of efforts to protect the environment.

Who should monitor the government's environmental protection efforts?

1.62 Many organizations monitor and report on the environmental performance of governments and other sectors. Some, such as the National Round Table on the Environment and the Economy, have a broad mandate to advise the federal government on its environmental policies. There is also a key role for Parliament's and the federal government's own auditors.

1.63 Prerequisites to good environmental stewardship are the development of environmental assessment and environmental auditing capabilities in departments. Environmental assessment is a pro-active step to identify and avoid — or mitigate — environmental problems. The recently passed Environmental Assessment Act makes this a legal requirement. The Green Plan also commits federal departments to environmental auditing beginning in 1992. This Office will be conducting a government-wide review of both the environmental audit and the assessment functions in departments in the future. I want to be able to report to Parliament whether departments and agencies are integrating environmental considerations in their planning processes and whether their own environmental auditors are efficiently and effectively carrying out their responsibilities and adhering to generally accepted auditing standards.

1.64 In the recently issued Code of Environmental Stewardship, the government committed itself to practising the principles of sustainable development in all aspects of its operations, including the procurement and disposal of goods and services and the management of equipment and real property over their life cycles. Given that sustainable development requires the integration of economic and environmental factors, consideration of environmental factors should now be

If these partnerships are to be truly successful, it is essential that there be a clear understanding of the roles, responsibilities and accountabilities of each partner.

an integral part of decision making in federal government programs and activities.

1.65 Accordingly, many of the Office's audits of government programs will have an environmental component. The challenge for this Office will be to determine how to audit the significant environmental issues in the most cost-effective and constructive way, in our value-for-money audits and in special examinations of Crown corporations. Through our audits of environmental issues, the Office will encourage improvement in environmental management and in accountability for environmental stewardship.

Reaping the Benefits of Information Technology

1.66 One of the challenges for government is to reap the benefits of information through the use of technology, while minimizing the risks, and the related costs, associated with large-scale computer projects. I support efforts to benefit from information technology, in terms of overall quality of service, responsiveness and good management of an organization's resources. The government can ill afford to ignore the huge savings that are possible through the innovative and cost-effective use of technology, but there is a potential risk of significant waste in implementing large-scale projects that entail the expenditure of hundreds of millions of dollars and extend over many years.

The government can ill afford to ignore the huge savings that are possible, but there is a potential risk of significant waste

There has long been concern about large computer development projects

1.67 Timely and accurate information is essential to government, and information technology is a vital tool for providing it. The government currently spends over $3 billion a year on information technology equipment, people and services.

1.68 During the 1960s and 70s, the government built large-scale systems to automate and increase the efficiency of clerical and administrative operations such as tax collection and the processing of unemployment insurance claims. Many of these systems have been modified over time, causing increased difficulty in assuring appropriate processing. The current challenge is to renew these aging systems to improve service to the public and increase productivity.

1.69 In past years, the Office has reported significant concerns about the management of computer systems. Various chapters have commented on the development of major systems that were over budget, behind schedule or simply abandoned. The Office reported that the government was realizing some benefit from the use of microcomputer technology, but that it was not clear how much. Previous reports have also focussed on concerns about the development of major financial systems and about the provision of adequate security and control measures for electronic data.

1.70 The Office has seen some signs of good management in recent reviews of departmental systems development. These include improved long-term departmental planning, the use of small-scale pilot projects and a concentration on projects that provide high returns in efficiency and savings. The Office is also pleased to note that central agencies have issued new guidance to encourage the innovative use of information technology.

The trend toward megaprojects continues

1.71 The government continues to invest heavily in new technology and systems. The Department of Supply and Services, for example, recently initiated a Public Service Compensation System with a preliminary cost estimate of $96 million; the Department of National Defence estimates $325 million for the completion of its new secure communications system; National Health and Welfare plans to invest an estimated $258 million to develop new delivery systems for its income security programs; and last year we reported on the External Affairs Canadian Online Secure Information and Communications Systems (COSICS) project, which will cost an additional estimated $138 million to complete. Some systems may take up to ten years from project planning to final implementation. The challenge for departments and agencies is to complete the systems on time and within budget. The new systems will radically change the way departments operate, and are expected to result in significant organizational restructuring.

1.72 There are huge sums involved; the stakes are high. I want to encourage efficient and effective administration through the appropriate use of technology. On behalf of Parliament, I want to make sure that everyone who has a role in systems development asks probing questions. Will the investment in technology improve service, increase productivity and support the department's strategies? Has the planning process included an analysis of the "lessons learned" from past experiences? Have "best practices" in the industry been incorporated in the proposed system? Has the sharing of data and systems among departments been considered? Is the return on the investment sufficient to justify the project? Has the project considered the full impact of the change on human resources in the organization?

1.73 Another issue is the role of the central and common–service agencies. Even with management reform in the public service and the resulting delegation of authority to departments, these agencies will still have a critical role to play. I think there has to be sufficient early challenge to any major projects that are presented. And, because of both the increasing complexity of systems development projects and the number of agencies involved, roles and responsibilities need to be clear, with someone taking the lead role.

1.74 Members of the Public Accounts Committee have expressed concern about the lack of flexibility and the rapid obsolescence of computer systems. They also have been concerned about achieving return on investment from technology expenditures. I have committed the Office to a program of reviewing the development of major computer systems in the government.

I think there has to be sufficient early challenge to any major projects that are presented.

Sustaining Reform in the Public Service is Essential

1.75 Last year I stressed the importance of management reform in this time of increasing global competitiveness and restraint in spending, with the attendant need for more efficient and effective government. The government embarked on its current "renewal" initiative, Public Service 2000 (PS 2000), in December 1989.

1.76 Public Service 2000, like initiatives in many other countries, aims to streamline government structures, processes and systems, and make the public service less costly, more productive, more innovative, and more service–oriented. It also aims to restore the public's confidence in its public service, and to ensure that a highly qualified, professional public service will be maintained to meet the needs of Canada and Canadians.

1.77 With the experience of the last year, I am even more convinced of the critical and urgent need to bring about the change in mindset that is the essence of public service renewal. Two aspects of this change that have not been adequately addressed are the need for more effective management and governmental accountability — with the emphasis on results rather than process — and the need to rethink the

I am even more convinced of the critical and urgent need to bring about the change in mindset that is the essence of public service renewal.

Because of its importance to taxpayers, parliamentarians need to know whether progress is being made.

whole concept of control, within the context of management reform. These issues are touched on elsewhere in this Report, including the next section on "Redefining the Place of Control".

Parliament needs to know the score

1.78 Public Service 2000 is a very ambitious initiative. It cannot succeed without highly visible leadership, including the support and goodwill of those at the political level. Leadership and support must be present — and be seen to be present — consistently over the long haul.

1.79 In the words of the Chairman of the Standing Committee on Public Accounts:

> "This reform is both important and desirable.... In the current climate of budgetary constraint, this may be the only means governments have of maintaining the current level of service provided to Canadians."

Because of its importance to taxpayers, this initiative deserves the interest and ongoing attention of all parliamentarians. They need to know about Public Service 2000 and whether progress is being made.

The government's report on progress is important

1.80 The government's first annual report on the state of the public service and progress in implementing Public Service 2000, called for in the White Paper on Public Service Renewal, was made public in late September 1992.

1.81 This report to the Prime Minister, for tabling in Parliament, presents the personal views of the former Clerk of the Privy Council on these matters. It illustrates through brief descriptions the variety of reform measures taken by central agencies and departments.

1.82 Given its recent release, this Office cannot provide detailed comment. However, in broad terms, the report's description of efforts under way in the public service is consistent with the impressions we have formed, based on our tracking of renewal activities in central agencies and various departments.

1.83 Although I have concerns about the extent to which renewal has taken root, I consider that the government's report will enhance parliamentarians' awareness of the situation.

1.84 **Future reports should focus on results.** Understandably, this first government report reflects progress primarily in terms of activities completed and ongoing in central agencies and departments. However, as implementation continues, progress should be evaluated and reported in terms of results; for example, information on overhead costs, productivity, employee attitudes about the work environment and their ability to meet service commitments, and the views of Canadians about the adequacy and costs of services provided. Timely reports of this nature should be available to Parliament.

1.85 As well, consideration of these reports by a parliamentary committee would be important as a means of influencing the nature, direction, and pace of change: as an opportunity for Parliament to ensure that momentum is maintained and that change is real rather than illusory — that Canadians are benefiting.

There is a general agreement that legislative change is needed, and is long overdue.

Our views on Public Service 2000

1.86 **Legislative change: a foundation stone not yet in place.** In December 1989 the government stated that it would bring forward amendments to the 25–year–old legislative framework that governs staffing, staff relations and other aspects of how public servants are managed. Bill C–26, the Public Service Reform Act, has since been introduced, gained approval in principle in the House of Commons, and been given lengthy consideration by a legislative committee. However, as I write this, almost three years after the initiative was begun, the passage of new legislation is still not certain.

1.87 It is my view that current public service human resource management systems — such as those for job classification and staffing — are too costly, and do not provide the flexibility or encourage the adaptability needed today. Legislative change is crucial to modernizing these systems.

1.88 Public service unions and others have opposed a number of the changes proposed in Bill C–26, and insist that different legislative changes are required. However, there is general agreement that legislative change is needed, and is long overdue — that the status quo is unacceptable.

1.89 One suggestion made to parliamentary committees is that the legislation governing human resource management in the public service should be reviewed by Parliament every five years. Such an approach has merit. It would lend itself to the introduction and assessment of new concepts that may be contentious. It might avoid, in future, the existing situation of a legislative framework that is viewed as having constrained positive change for too long.

1.90 **Departmental implementation: at an early stage.** With a few notable exceptions, departments are at an early stage in implementing their renewal initiatives. Genuine efforts are being made to improve service delivery and the way public servants are managed -- the key themes of Public Service 2000. Many projects are under way.

1.91 A number of renewal initiatives have been highly visible and have sought to involve employees at all levels. Evidence of some employee "buy–in" exists. But there are also departments where it has been primarily a "top down" approach, with limited employee involvement so far.

1.92 The focus of activities and rate of change vary considerably, both within and among departments. Our overall sense is that, even in the departments whose initiatives are more advanced, the process of change remains fragile. Much remains to be done to fully engage public servants — managers and employees at all levels.

The process of change remains fragile.

1.93 **Changing attitudes: a major challenge.** Bringing about a change in attitudes in an organization as large, diverse, and decentralized as the public service of Canada would present a challenge under the best of conditions. To attempt it in a climate characterized by labour unrest, financial restraint, budget and staff reductions, and other uncertainties that bear not only on the organization structure of the public service but on the job security of individuals, adds significantly to the difficulty of effecting change. It is important to not underestimate the task.

1.94 **Leadership from the top remains critical.** Strong leadership from the Clerk of the Privy Council, with the support of other senior executives, has enabled the seeds of renewal to be planted. However, my concern is whether the necessary commitment is always present in departments and agencies — whether all that could be done is being done. In particular, I wonder if improved human resource management and the long–term health of the public service are being given the priority across government that they warrant.

Central commitment that is highly visible, and sustained, continues to be essential.

1.95 For renewal to take root throughout the public service, and for momentum to be maintained where it now exists, central commitment that is highly visible, and sustained, continues to be essential. As the White Paper states, deputy heads must be held accountable "to promote vigorously the implementation of Public Service 2000 in their departments".

1.96 **Full benefits of reform: still to come.** It is clear that a great deal of effort has been expended in developing a roadmap for change and in taking the first steps toward renewal. Some signs of service improvement are apparent. But in my judgment, the taxpayers of this country — and the employees of the public service — are still a long way from reaping the full benefits of public service reform.

There is an urgent — and I stress urgent — need for the government to give public servants some general guidance on the place of control.

Redefining the Place of Control

1.97 The government has identified the need to eliminate unnecessary controls and to delegate authority to public servants. Does this mean the government needs fewer controls — or different controls — to achieve appropriate overall control?

1.98 At this stage in the reform process, I see a need to draw to Parliament's attention the urgent — and I stress urgent — need for the government to give public servants some general guidance on the place of control in the new environment to be created under Public Service 2000. I believe that there are lessons about control that can be learned from the private sector, which has gone through a similar shift in management focus.

The impact of public service reform on control

Companies found that the need for effective control didn't change, but the nature and location of control did.

1.99 The Office visited 40 large organizations in the private and public sectors and published the results in a report entitled "Internal Auditing in a Changing Management Culture". These organizations spoke of a changing business environment, with globalization, downsizing, increased competition, environmental protection, and new technologies. They also spoke of fundamental changes in management to deal with new realities. There are obvious parallels between these changes and the current efforts at management reform in the public service.

1.100 The vast majority of the organizations now view internal control in a much broader way than as traditional financial controls. Control is an integral part of achieving results. These organizations have made substantial reductions in their layers of management and have given more individual responsibility, or empowerment, to line managers. The result is that many traditional central controls are gone; a layer of managers who controlled things directly from the centre is also gone.

1.101 Nevertheless, these companies and others see control as essential to success in today's highly competitive business world. Companies found that the need for effective control didn't change, but the nature and location of control did. The trend is to eliminate unnecessary controls or to transfer controls from corporate centres to the field, with more decision authority being placed in the hands of lower–level managers.

1.102 In making this change, companies recognize that the design of control measures has to be responsive to the business risks in different circumstances. Accordingly, companies are moving to central strategic control while providing front–line employees with basic rules, information, technology, and training.

1.103 The federal government could learn from this trend. Chapter 4, Change and Control in the Federal Government, studies the question of effective control as part of public service reform. In shifting more decision–making authority to front line public servants, Public Service 2000 will affect control and accountability. The study suggests that this devolution of decision–making authority requires a modern and positive view of control. The challenge is to implement a new control framework that has the confidence of Parliament, central agencies and managers across the public service.

Central agencies and departments must manage the risks of delegation

1.104 Chapter 7 on the application of the Work Force Adjustment Policy reports on how departments handled some of the 13,000 payments and other benefits granted to public servants declared surplus who resigned before being laid off. About one third of the payments examined were well founded and in keeping with the intent and letter of the Policy. The results of the audit bring the lack of overall management control, probity, prudence and propriety into question. The Office found weaknesses in the human resource management framework at the departmental and central agency levels. Why did this occur? What are the lessons to be learned about management control in an environment of increasing delegation?

1.105 Where workforce adjustments were found to have been well managed, the Office observed that managers had an understanding of the purpose of the work force reduction and of the context in which it was to be done. There was leadership starting at the top, providing direction and fostering commitment through participation and communication. There were sound management frameworks — including controls.

All players should work in partnership

1.106 There needs to be a partnership between all the players in central agencies and those in departments and there is a need for them to clarify their respective roles and responsibilities. While there is an obligation on the part of managers to inform central agencies of their activities, there is also an obligation on the part of central agencies to monitor what is happening in the field. Someone has to be looking at the big picture.

1.107 The government has articulated a set of values for the public service that are firmly rooted in the institutions of democratic government. It is essential that all those in the public service work by these values and monitor their own performance. In the White Paper on Public Service Renewal, the government has stated these values as:

- service to Canada and to Canadians;
- loyalty to the duly elected government;
- honesty, integrity and non-partisanship;
- prudence in the use of taxpayers' money;
- faithfulness to the principles of fairness and impartiality;
- professionalism in carrying out their duties; and
- respect for ministers, other parliamentarians, members of the public and other members of the public service.

Values like these should form the foundation of control.

Promoting Answerable, Honest and Productive Government

1.108 I came to the Office of the Auditor General with respect for our national institutions and with optimism about the future of our country. My feelings have not changed; they have only been affirmed. I believe that at this time in the history of our country, when fundamental questions are being raised about its future, this Office can play a role by continuing to encourage economical, efficient and effective government. I think we owe it to past generations, who have built a strong nation, to preserve this heritage and to build on it.

Someone has to be looking at the big picture.

Values like these should form the foundation of control.

1.109 Two common themes in this chapter are the role of stewardship in government departments and agencies, and Parliament's monitoring role in the interest of all Canadians. It is obvious, during these difficult economic times, that there is a need for mutual respect, a shared sense of rights and accompanying obligations, and a commitment to frank dialogue between government and the taxpayers. There must be good communication between these parties, and truth in budgeting and reporting.

During the balance of my tenure I am committed to doing my part to strengthen the government's financial administration.

1.110 During the balance of my tenure I am committed to doing my part to strengthen the government's financial administration. This is essential to a strong, healthy country for this and future generations. Two immediate, urgent goals are to put accountability into operation and to ensure that Parliament is provided with better information on the deficit. The national debt is serious but far from hopeless. I would like to see taxes put to work for Canadians, rather than seeing them used to pay interest on the public debt; to see Parliament provided with more future–oriented information on the debt and the deficit, as well as more comparisons of planned performance with actual performance.

1.111 I am personally committed to making a difference for Canadian taxpayers by promoting, in all the Office's work for Parliament, answerable, honest and productive government. I intend that our audits will provide objective information and advice to Parliament, to promote accountability and the best practices in government operations.

1.112 We must keep our faith in our ability to improve things; we must never lose our optimism nor our belief that we can learn from history; and we must work together to find practical solutions that will narrow the elusive gap between the ideal and the possible.

Follow–up and Other Audit Observations

The Follow–up and Other Audit Observations have been conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Committee (PSAAC) of the Canadian Institute of Chartered Accountants.

Chapter 2

Other Audit Observations

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Other Audit Observations

Main Points

2.1 The Auditor General Act requires the Auditor General to include in his annual Report matters of significance that, in his opinion, should be brought to the attention of the House of Commons.

2.2 The Other Audit Observations chapter fulfils a special role in the annual Report. Other chapters normally describe the findings of the comprehensive audits we perform in particular departments; or they report on audits and studies of issues that relate to operations of the government as a whole. The Other Audit Observations chapter is used to report individual matters that have come to our attention during our financial and compliance audits of the Public Accounts of Canada, Crown corporations or other entities. It is also used to report some specific matters that have come to our attention during our comprehensive audits.

2.3 The chapter contains a wide range of observations on departmental operations. The issues addressed generally concern failure to comply with authorities, poor cash management practices, inadequate control over revenue and the expenditure of money without due regard to economy.

2.4 Although the individual audit notes report matters of significance, they should not be used as a basis for drawing wider conclusions about matters we did not examine.

Introduction

2.5 This chapter contains matters of significance not included elsewhere in the annual Report that we believe should be drawn to the attention of the House of Commons. The matters reported have come to our notice during our financial and compliance audits of the Accounts of Canada or during our comprehensive, value–for–money audits.

2.6 Section 7(2) of the *Auditor General Act* requires the Auditor General to call to the attention of the House of Commons any significant cases where he has observed that:

- accounts have not been faithfully and properly maintained or public money has not been fully accounted for or paid, where so required by law, into the Consolidated Revenue Fund;
- essential records have not been maintained or the rules and procedures applied have been insufficient to safeguard and control public property, to secure an effective check on the assessment, collection and proper allocation of the revenue and to ensure that expenditures have been made only as authorized;
- money has been expended other than for purposes for which it was appropriated by Parliament;
- money has been expended without due regard to economy or efficiency; or
- satisfactory procedures have not been established to measure and report the effectiveness of programs, where such procedures could appropriately and reasonably be implemented.

2.7 Each of the matters of significance reported in this chapter was examined in accordance with generally accepted auditing standards, and accordingly our examinations included such tests and other procedures as we considered necessary in the circumstances. The matters reported should not be used as a basis for drawing conclusions about matters not examined. The instances that we have observed are described in this chapter under the appropriate department heading.

The audit notes contain matters of significance that the Auditor General is drawing to the attention of the House of Commons.

Observations on Departmental Operations

The Government of Canada

Inappropriate use of section 5 of the Department of Agriculture Act as authority to spend $17.3 million on forestry matters and failure to correctly report the expenditure to Parliament

This Office has reported previously on the Department of Agriculture's extensive use of section 5 of the Department of Agriculture Act and Governor in Council authority to create new programs. Until recently this use had been restricted to matters related to agriculture. In 1992, the government used section 5 to provide assistance to the Province of Manitoba for costs incurred as a result of its 1989 forest fires. In our view, the Department of Agriculture Act does not provide authority for spending related to forest fires. Such authority might be found, among other places, in either the Department of Forestry or Forestry Acts. By circumventing the use of these Acts, the transaction was not correctly reported to Parliament.

2.8 **Background.** In 1987 and again in 1989, our Office reported on the erosion of accountability and of parliamentary control resulting from the Department of Agriculture's use of section 5 of the Department of Agriculture Act and Governor in Council authority to create new programs. Section 5 provides that the "Governor in Council may assign any other power or duty to the Minister". In the case of another department, we reported that a section with words similar to section 5 was interpreted as providing the power to re–assign existing powers and duties, but not the power to create new ones.

2.9 Regardless, the Department has made frequent use of this section to set up new programs and spend billions of dollars. By 1989, the Department had spent over $3 billion based on the use of section 5. Since then, an additional $900 million has been spent under this authority. As noted in the Auditor General's 1989 Report, Parliament has little opportunity to debate the programs that section 5 authorizes, and little basis for scrutinizing them even though it is being asked to vote moneys to fund them.

Parliament has little opportunity to debate the programs that section 5 authorizes, and little basis for scrutinizing them even though it is being asked to vote moneys to fund them.

2.10 Until 1992 the expenditures that have come to our attention have been restricted to agricultural matters. However, in 1992 the government used section 5 of the Department of Agriculture Act as its authority to spend $17.3 million to assist the Province of Manitoba with costs incurred as a result of its 1989 forest fires. In our view, the current Department of Agriculture Act does not provide any authority for forestry matters. However, section 9 of the Department of Forestry Act and section 3(c) of the Forestry Act are quite specific in allowing the Minister of Forestry to conclude agreements with the provinces for the purposes of forest protection.

2.11 The following comprises a brief account of the key events that led the Department of Agriculture to pay for the costs incurred as a result of forest fires:

- In November 1988, the Canadian Crop Drought Assistance Program was announced in response to the severe drought experienced by producers in various regions of Canada. Subsequently, the participating provinces agreed to share 25 percent of the program's cost. As of October 1990, the Province of Manitoba was the only participating province that had not signed a Canadian Crop Drought Assistance Program agreement with the Government of Canada.
- In the spring and summer of 1989, the Province of Manitoba experienced severe forest fires, resulting in the evacuation of almost 24,000 people and expenditures exceeding $63 million.
- According to Department of Agriculture officials, the province, in its endeavour to recover approximately $30 million of its 1989 forest fire costs, delayed signing a Canadian Crop Drought Assistance Program agreement and, hence, effectively forestalled its $37.7 million contribution.
- In March 1992, the Government of Canada agreed to assist the Province of Manitoba for up to $30 million of the Province's costs resulting from the 1989 forest fires. The quid pro quo was that the Province of Manitoba would sign a Canadian Crop Drought Assistance Program agreement and pay Canada the $37.7 million that it owed.
- Under the authority of section 5 of the Department of Agriculture Act, $17.3 million was to be paid for costs incurred as a result of the forest fires. The remainder was paid out appropriately by two other federal departments for the amounts of $1.3 million and $11.4 million, under their respective legislation.
- The Department of Agriculture's amount was offset against the $37.7 million due to Canada under the Canadian Crop Drought Assistance Program. The outstanding balance of $20.4 million was to be paid by the Province of Manitoba in instalments.

- Order-in-council approval was given using section 5 of the Department of Agriculture Act, to enter into an agreement to effect the $17.3 million transaction.

2.12 **Issues.** In our view, section 5 of the Department of Agriculture Act does not give the Government of Canada authority to act in forestry matters. Had either the Department of Forestry Act or the Forestry Act been used as the authority for the expenditure, the Department of Forestry would have required a supplementary estimate to fund it.

2.13 In accounting for this transaction the Department of Agriculture netted the forest fire costs against the recovery of the expenditure under the Canadian Crop Drought Assistance Program, thereby failing to correctly report the $17.3 million expenditure and understating by that amount the amount spent under Vote 15 — Grants and Contributions. The Department's non-tax revenue is understated by the same amount. The transaction was thus carried out without proper authority, and was not properly recorded in the accounts.

2.14 **Conclusion.** In our opinion, the expenditure could have been properly made and disclosed if two separate agreements had been implemented: the first between the Province of Manitoba and the federal Minister of Forestry for $17.3 million, and a second agreement with the federal Minister of Agriculture for the provincial contribution of $37.7 million under the Canadian Crop Drought Assistance Program.

Department's response: *The Department of Agriculture concurs with the facts as presented above. However, as in the past, the Department continues to disagree with the Auditor General's interpretation on the use of section 5 of the Department of Agriculture Act. Legal counsel for Agriculture Canada supports the departmental position that the use of section 5 in this instance was appropriate.*

Department of Agriculture

Lack of adequate controls over payments made to the Farm Credit Corporation for Farm Debt Review Fund Concessions

The Department of Agriculture did not establish effective financial management and control over payments of $160 million from the Farm Debt Review Fund, made by the Department from the inception of the Fund in December 1986 to 31 March 1992. In our opinion, the Department needs to ensure that the terms and conditions that form the basis of payments, and the documentation required as evidence thereof, are clearly defined and built into the design of its programs, and ensure that these requirements are clearly communicated and understood by all participating organizations. Further, the Department should implement timely ongoing post-audit compliance procedures.

When the reimbursements were authorized, the Department did not know whether the concessions met the conditions for reimbursement.

2.15 **Background.** The Farm Debt Review Act was enacted in June 1986 to facilitate financial arrangements between farmers and creditors. The Act established a Farm Debt Review Board (FDRB) in each province. The Boards were to provide mediation services to assist farmers who were in financial difficulty or insolvent to reach agreements with their creditors. The FDRBs are managed and funded by the Department of Agriculture.

2.16 The Farm Credit Corporation (FCC) is a wholly owned federal Crown corporation and a major holder of farm mortgages, which formed a significant portion of troubled farm debt when the FDRBs were created. In December 1986, the Farm Debt Review Fund was established by an order-in-council pursuant to section 5 of the Department of Agriculture Act. It authorized the Minister of Agriculture to reimburse the FCC for certain types of concessions to farmers, arising from FDRB–mediated negotiations. The reimbursement would be in the form of a payment to the FCC from the Fund on behalf of the farmer. Total expenditures from the Fund were initially approved at $30 million and, in April 1988, the amount was increased by $300 million.

2.17 The order–in–council set out the conditions that a concession had to meet to be reimbursed from the Fund. First, the FCC had to satisfy itself that the farmer had demonstrated management ability, and a satisfactory plan of operations that indicated the future viability of the farming operation. Second, FCC concessions to farmers that were proportionately greater than those given by other secured creditors were not reimbursable. The Fund was available only to the FCC.

The Department was unreasonably slow in implementing post–audits to assess whether the reimbursements made from the Fund were warranted.

2.18 The Department approved reimbursements to the FCC from the Fund based on a listing submitted by the FCC of concessions made to each farmer. Accordingly, when the reimbursements were authorized, the Department did not know whether the concessions met the conditions for reimbursement. Making payments before obtaining evidence of compliance with governing authorities is acceptable, provided that it is followed soon by a post–audit of the organization to whom the payments were made, to assess compliance with the terms and conditions establishing eligibility. The order–in–council assigned the Department the duty to do just that. However, for a reasonable basis for post–audit, it is essential that the Department ensure that the terms and conditions establishing eligibility are clearly defined; that these definitions are understood and agreed to by the recipient organization, along with agreement on requirements for documentation to provide sufficient and appropriate evidence that the eligibility criteria have been met; and that the post–audits are timely to ensure that problems are identified and resolved early.

2.19 In June 1989, the Department's internal audit division reported that post–audits of payments made by the Department to the FCC had not been done and recommended that the Department undertake to do them. We also raised this with the Department in a management letter in connection with our audit of the summary financial statements of Canada for the year ended 31 March 1989, and in 1990 and 1991 as well. The Department agreed with our observation and stated its intention to undertake post–audits in June 1990, designed to provide the Department with assurance as to the validity of claims paid and an assessment of the FCC's internal controls and procedures over such claims.

2.20 The results of the first post–audit were not reported until March 1991, some five years after the first payments were made from the Fund and after the Department had authorized payments for $120 million, to 31 March 1991. In our opinion, the Department was unreasonably slow in implementing post–audits to assess whether the reimbursements made from the Fund were warranted. The delay in implementing post–audits is surprising, as there is evidence in departmental records as early as 1988 raising concerns that some of the claims made by the FCC might not be in accordance with the viability criteria set out in the order–in–council.

2.21 The Department made further payments for some $40 million from 1 April 1991 to 31 March 1992 after receiving independent evidence from post audits in March 1991 and again in December 1991 that raised concerns as to whether what it had already paid had been in compliance with the order–in–council.

2.22 To assess whether the concessions were in compliance with the order–in–council, the independent auditors engaged by the Department to carry out the post audits established audit criteria that among other things, expected the FCC concession files to contain clear documentation demonstrating management ability; and to also contain adequate financial statements and a satisfactory plan of operations demonstrating future viability of the farming unit. They also expected the plan of operations to include an analysis of the net effect of the proposed concession(s) on the borrower's cash flow and profitability. Finally, they did not believe that the criterion of proportionality could be met if other secured creditors did not participate in the FDRB process or grant a concession to the borrower. In December 1991, the auditors reported that:

- most of the FCC concession files tested did not contain documentation to determine if the management ability criterion had been met;
- many of the FCC concession files tested did not contain sufficient and appropriate documentation to determine if the future viability of operations criterion had been met; and
- over half of the FCC concession files tested did not meet the proportionality criterion.

2.23 At the time that the post audit took place, there was not a clear definition of viability in place and agreed to by all parties.

2.24 **Issue.** In our opinion, post–audit control did not provide a meaningful financial management control because the Department did not clarify the terms and conditions of the order–in–council (such as future viability and proportionality); did not communicate to the FCC its requirements for sufficient and appropriate evidence to demonstrate compliance with the order–in–council; and did not carry out the audits on a timely basis.

2.25 In May 1992, with less than one year left for approving payments from the Fund, the Department and the FCC agreed on criteria to support viability based on a proposal put forth by the Department. The Department did not do any research and analyses in developing this proposal to the FCC. Authoritative research in this field indicates that the agreed upon criteria are excessively optimistic as they do not give adequate consideration to, among other things, an adequate reserve for unexpected expenses and equipment replacement, or the capacity to absorb even small adverse trends in harvests or markets.

Many of the Farm Credit Corporation concession files tested did not contain sufficient and appropriate documentation to determine if the future viability of operations criterion had been met.

2.26 In June 1992, the Department requested and received order–in–council approval redefining proportionality. The revised order–in–council requires the FCC to act as any other responsible creditor in similar circumstances given its relative and net security position.

2.27 **Conclusion.** In our opinion, the Department needs to improve its systems and procedures to ensure that the terms and conditions that form the basis of payments, and the documentation required as evidence thereof, are clearly defined and built into the design of its programs; and to ensure that these requirements are clearly communicated and understood by all participating organizations. Further, the Department should implement timely ongoing post–audit compliance procedures for all programs under which payments are subject to this form of financial management control — normally within one year of the start of a new program. We noted similar concerns about the effectiveness of post–audit compliance procedures in our 1992 value–for–money audit of the farm income support programs.

Post–audit control did not provide a meaningful financial management control.

Department of Agriculture's response: *The Department agrees with the general thrust of these observations. However, the Department believes that its approach to this contribution arrangement is consistent with dealing with another federal government agency reporting to the same Minister in that it relied on FCC's knowledge and expertise to manage the Fund. When inconsistencies were discovered by the Department's audit, corrective action* *was taken to address the identified problems.*

Department of Finance

Tax arrangements for foreign affiliates are costing Canada hundreds of millions of dollars in lost tax revenues

In 1987 the Department of Finance announced that it would review the tax rules on interest deductibility, foreign–source income and foreign affiliates. The reviews have not been completed. In our view, the tax base is vulnerable and Canada has lost hundreds of millions of dollars in tax revenues.

2.28 **Background.** In our 1986 Report (Chapter 4, Income Tax Expenditures) we noted our concerns about tax avoidance mechanisms. We pointed out that it is both legitimate and advisable for taxpayers to seek expert advice on how to minimize their tax costs. However, although such advice can produce tax savings for them, it may subvert or greatly reduce the effectiveness of taxation provisions. Unlike tax expenditures, which give tax relief to taxpayers who have fulfilled conditions that further the government's specific economic and social objectives, tax avoidance mechanisms do not. They do not relate to any specific legislative objectives and may usually be seen as frustrating the general intent of tax legislation.

2.29 Avoidance mechanisms also have a negative effect on the equity and integrity of the tax system and on public attitudes toward voluntary compliance. Access to such mechanisms is usually limited to those who can afford expensive advice. Those who cannot, therefore, may be denied equitable or even–handed treatment.

2.30 Recognizing that it is virtually impossible to anticipate every tax avoidance mechanism, we recommended in 1986 that, when they are identified, the government act to eliminate them.

2.31 The Standing Committee on Public Accounts, in its Report of 20 December 1989 dealing with a federal sales tax avoidance problem, recommended that the Department of Finance ensure that tax avoidance be closely monitored, and that it put forward proposals for dealing as soon as possible with significant revenue losses when those losses become apparent.

2.32 The Income Tax Act provisions dealing with the foreign affiliate rules and foreign source income are complex, as are the arrangements for foreign affiliates. It is our intention to explain the situation fairly and without undue complexity. Our concern is with transactions that can be structured to circumvent the intent of the law.

2.33 **Issues.** In 1987 the Department of Finance announced that it would review the tax rules on interest deductibility, foreign–source income and foreign affiliates. The reviews have not been completed.

Tax arrangements for foreign affiliates are a concern for the Department of National Revenue – Taxation.

2.34 Tax arrangements for foreign affiliates are a concern for the Department of National Revenue — Taxation (NRT). On a number of occasions, NRT has advised the Department of Finance about concerns it has with existing legislation.

2.35 **Interest deductibility.** In very general terms, the law allows a Canadian–resident corporation to deduct interest on funds it borrows for the purpose of investing in a foreign affiliate. It is not necessary to match the interest expense for that investment with the income it generates.

2.36 When a Canadian company carries on business outside Canada through a foreign affiliate, the interest expense associated with its investment in the foreign affiliate can be deducted in Canada, while the related income is reported in the foreign jurisdiction. The Department of Finance has advised us that this treatment is in accordance with that of other countries and that it is designed to encourage international competitiveness.

2.37 That deduction of interest reduces Canada's tax revenue and, at the same time, the related income is not necessarily subject to tax in Canada — it may be received as a tax exempt dividend and may never appear in the Canadian tax base. This exemption was intended as a proxy for a Canadian system of foreign tax credits.

2.38 Even if dividends from their foreign affiliates in high–tax countries were included in the income of Canadian corporations, any Canadian tax payable would be offset by the Canadian tax credits given for the underlying foreign taxes, paid by the foreign affiliates. This would produce no tax for Canada (to do otherwise would result in double taxation), but the corporations could deduct any related interest from their income in Canada.

2.39 If the exemption system were repealed, there would still be the issue of deferral. In other words, the interest cost to the Canadian corporation would be deductible in the current year, but dividends from its foreign affiliates would be included in income only as they were received.

2.40 If Canada's tax rates are higher than those of other jurisdictions there is an incentive to incur and deduct interest in Canada.

2.41 In 1990 the Department of Finance advised us that the issue of matching interest expense with related income had already been "the subject of extensive review with a view to arriving at a proper tax policy".

2.42 **Tax exempt dividends from foreign affiliates.** The rules on foreign affiliates enable a Canadian corporation to receive, tax free, active business income earned by its qualified foreign affiliates. Such a foreign affiliate must be resident in one of the countries designated in the Income Tax Regulations (see Exhibit 2.1), and the active business income must be earned in a country so designated, or in Canada. The dividends are not subject to Canadian tax, on the basis that the underlying income has been taxed by a foreign state at a rate that approximates Canadian rates. As previously mentioned, exempting dividends from tax was intended as a proxy for a Canadian system of foreign tax credits.

Certain dividends are not subject to Canadian tax on the basis that the underlying income has been taxed by a foreign state.

2.43 As Exhibit 2.1 shows, a number of the designated countries have low tax rates or are tax havens, and certain types of income earned in them thus may not be subject to tax at a rate that approximates Canadian rates.

2.44 Also, a foreign affiliate in a tax haven country that is not designated

Exhibit 2.1

Designated Countries
(Certain dividends from these countries can enter Canada tax free)

COUNTRIES WHERE A TREATY IS IN EXISTENCE

Australia
Austria
Bangladesh
BARBADOS
Belgium
Brazil
Cameroon
China
Côte d'Ivoire
CYPRUS
Denmark
Dominican Republic
Egypt
Finland
French Republic
  European Departments, Saint–Pierre and Miquelon, overseas departments of Guadeloupe, Guyane, Martinique, Réunion, but not including overseas Territories

Germany
Guyana
India
Indonesia
IRELAND
ISRAEL
Italy
Jamaica
Japan
Kenya
Korea
Malaysia
MALTA
Morocco
NETHERLANDS, not
  including the Netherlands Antilles
New Zealand, not
  including Cook Islands, Niue or Tokelaw

Norway, not
  including Svalbard (including Bear Island), Jan Mayen and the Norwegian dependencies outside Europe
Pakistan
Philippines
Romania
SINGAPORE
Spain
Sri Lanka
Sweden
SWITZERLAND
Thailand
Trinidad and Tobago
Tunisia
USSR
U.K. and Northern Ireland
U.S.A., not including its
  Territories
Zambia

COUNTRIES WHERE A TREATY HAS BEEN SIGNED, BUT IS NOT IN FORCE YET

LIBERIA

COUNTRIES WITHOUT A TREATY

ANTIGUA
Argentina
Belize
DOMINICA

MONTSERRAT
PORTUGAL[1]
SAINT KITTS and
  NEVIS–ANGUILLA

SAINT LUCIA
SAINT VINCENT
Senegal

Countries in *ITALIC* are often referred to as tax havens.

[1] Mederia is considered to be a tax haven.

Income earned in a tax haven may receive preferential treatment over income earned in Canada and subjected to Canadian tax.

may technically be resident in a designated country; dividends from it can then be passed on to its Canadian affiliate without being subject to Canadian tax, even though the underlying income has not been subject to foreign tax at a rate that approximates Canadian rates. The Department of National Revenue — Taxation is aware of a number of taxpayers who have used this scheme to be in a position to move $500 million into Canada tax free.

2.45 Determining residency is a complex matter and is a question of fact.

2.46 The system was intended to ensure that income entering Canada would be taxed by Canada if it had not been previously taxed by a foreign state at a rate that approximated Canadian rates. This is not what is happening in many situations.

A number of schemes have been devised to convert a taxable distribution into a tax–exempt distribution.

2.47 To further complicate matters, low–taxed or tax–free offshore income of a Canadian corporation carries the same federal and provincial tax credits for Canadian shareholders, on dividends paid to them, as taxed income from a Canadian source. Income earned in a tax haven may thus receive preferential treatment over income earned in Canada and subjected to Canadian tax. In our view, this provides an incentive to maximize the income of a foreign affiliate. In 1990 the Department of Finance advised us that the amounts claimed as tax credits in such cases are "not likely to be of significant magnitude to warrant legislative action".

2.48 Taxable dividends from foreign affiliates. Dividends received from non–qualified foreign affiliates (those resident in a country not designated in the Income Tax Regulations), and dividends received from income other than active business income of qualified foreign affiliates, are considered to be paid out of taxable surplus. These dividends are taxable on entering Canada, with a credit given to the Canadian corporation for the underlying foreign tax paid by the foreign affiliate. Consequently, there is an incentive to defer such distributions, or to disguise them, when the foreign affiliate's income is subject to foreign tax rates that are lower than Canadian tax rates.

2.49 A number of schemes have been devised that often are referred to as "surplus stripping" schemes. These involve the conversion of taxable surplus into tax–exempt surplus. It is also possible to use an "upstream loan" scheme to disguise a distribution into Canada — a foreign affiliate distributes money to a Canadian parent or affiliate by way of a loan or share purchase.

2.50 Other related problems. A number of other problems have been identified. We comment on one below.

2.51 Foreign Accrual Property Income (FAPI). The FAPI rules are a key anti–avoidance element of the current system. Their purpose is to eliminate the tax advantage of earning passive investment income, such as interest in a controlled foreign affiliate. This is done by attributing the passive investment income earned by the foreign affiliate to the Canadian shareholders.

2.52 A key concern is the fact that the Income Tax Act does not define active or passive income in the context of the FAPI rules. The absence of a definition is of concern to the Department of National Revenue — Taxation. It makes the law difficult to administer and difficult for taxpayers to comply with. The limited case law indicates that the meaning of active business income for purposes of FAPI rules may be derived from the case law dealing with the pre-1979 meaning of active business income in the context of the small business deduction rules. That case law gives a very broad meaning to active business income. The meaning of active business income for purposes of the small business deduction rules was subsequently altered by specific amendments to the Income Tax Act. These amendments were not extended to the FAPI rules. Accordingly, the meaning of passive income for the FAPI rules may be very narrow. As a result, there is no reasonable assurance that the rules will apply in all circumstances where they should.

2.53 The General Anti–Avoidance Rule (GAAR) was enacted in September 1988, subsequent to the tax arrangements for foreign affiliates referred to in paragraph 2.56. The General Anti–Avoidance Rule will apply to tax arrangements which result in a misuse of the provisions of the Income Tax Act or an abuse, having regard to the Act read as a whole.

2.54 We are unable to provide Parliament with reasonable assurance that GAAR will have any significant impact on the problems identified in this note. Tax arrangements for foreign affiliates continue to be of concern to the Department of National Revenue — Taxation and in September 1990, it again advised the Department of Finance of its concerns. As of September 1992 no reassessments have been issued under GAAR.

2.55 **How taxpayers use the rules.** These tax rules are being used to:

- transfer foreign subsidiaries' losses to their Canadian parents;
- move Canadian corporations' income offshore; and
- convert income of Canadian corporations into tax–free income.

2.56 The Netherlands Antilles, Barbados and the Netherlands often are referred to as tax havens. The following tax arrangements for foreign affiliates have been identified by the Department of National Revenue — Taxation.

- A Netherlands Antilles subsidiary (under Canadian tax law the company is a resident of Switzerland but under Swiss law it is not considered to be a resident of Switzerland) of a Canadian company had assets of $865 million and income of $92 million not subject to the FAPI rules. Although the income of the foreign subsidiary has not been taxed at a rate that approximates Canadian rates, it can be transferred to the Canadian parent as tax–free dividends. The offshore income is not taxed on entering Canada, but it carries with it federal and provincial tax credits on dividends paid out to Canadian shareholders. The Canadian parent incurred the financing costs for its investment in the subsidiary and reported a tax loss in Canada of $29 million.
- A Canadian company transferred $318 million in investments to its Barbados subsidiary, which generated income of $37 million, not subject to the FAPI rules, in six months. Although the income of the subsidiary has not been taxed at a rate that approximates Canadian rates, it can be transferred to the Canadian parent as tax–free dividends. The offshore income is not taxed on entering Canada, but it carries federal and provincial tax credits on dividends paid to Canadian shareholders. The Canadian parent incurred the financing costs for its investment in the Barbados subsidiary and reported a tax loss in Canada.
- A Canadian company's U.S. affiliate has $684 million in cash and short–term deposits, which originated in the Canadian company. Investment income earned by the U.S. affiliate was used to absorb its U.S. tax losses. The related interest expense for the investment in the U.S. subsidiary is deducted in Canada. Although the Department of National Revenue — Taxation deemed that the investment income was subject to withholding tax, this scheme had the effect of transferring U.S. tax losses to Canada.
- Another Canadian company's U.S. affiliate has $672 million in cash and short–term deposits, which originated in the Canadian

In September 1990, the Department of National Revenue – Taxation again advised the Department of Finance about concerns it has with existing legislation.

Taxpayers can transfer foreign subsidiaries' losses to their Canadian parents; move Canadian corporations' income offshore; and convert income of Canadian corporations into tax–free income.

company. Investment income earned by the U.S. affiliate was used to absorb its U.S. tax losses. The related interest expense for the investment in the U.S. subsidiary is deducted in Canada. This scheme effectively transferred U.S. tax losses to Canada.

Canadian corporate taxpayers "invested" $16.1 billion in Barbados, Cyprus, Ireland, Liberia, the Netherlands and Switzerland, all considered tax havens. In 1990 Canadian companies received over $600 million in dividends from these countries.

- A Canadian company's Hong Kong affiliate has $62.4 million in cash and short–term deposits, which originated in the Canadian company. Investment income earned by the Hong Kong affiliate was used to absorb its Hong Kong tax losses. The related interest expense for the investment in the Hong Kong subsidiary is deducted in Canada. This scheme effectively transferred Hong Kong tax losses to Canada. The Department of National Revenue — Taxation's tax avoidance unit has been reviewing this case since 1990.
- A Canadian company has $1.6 billion in interest–free advances and a $133 million investment in its Netherlands' foreign affiliate. This investment generated $130 million in income not subject to the FAPI rules for the foreign affiliate. Although the income of the foreign affiliate was not taxed at a rate that approximates Canadian rates, the $130 million can come to the Canadian company tax free. This offshore income is not taxed on entering Canada, but it carries federal and provincial tax credits on dividends paid out to Canadian shareholders. The Canadian company reported a tax loss.

2.57 Significant amounts of tax revenue are at risk. The cases cited above indicate the magnitude of the situation. There are also other indicators of magnitude.

In our view it is reasonable to conclude that hundreds of millions of dollars in tax revenue have already been lost and will continue to be at risk.

- We analyzed National Revenue — Taxation's 1990 information return (T106) database. We found that at that time Canadian corporate taxpayers had "invested" $92 billion ($42 billion in loans and $50 billion in equity) in non–resident companies that they were not dealing with at arms' length and, in 1990, they had received over $4.2 billion in dividends from them.

  Of this total amount of $92 billion:

  $5.2 billion was "invested" in companies in Barbados, a tax haven. In 1990 Canadian companies received over $400 million in dividends from companies in Barbados. Active business income earned in Barbados can enter Canada tax free. This income carries federal and provincial tax credits on dividends paid out to Canadian shareholders.

  $10.9 billion was "invested" in companies in Cyprus, Ireland, Liberia, the Netherlands and Switzerland, all considered tax havens. In 1990 Canadian companies received over $200 million in dividends from companies in these countries. Active business income earned in these countries can enter Canada tax free. This income carries federal and provincial tax credits on dividends paid out to Canadian shareholders.

  The information returns do not indicate the full extent of the financial activity between parties in Canada and in foreign states. They disclose only transactions that are technically defined as not arms' length. For example, a Canadian company that has a 50 percent interest in a company resident in a designated tax haven country and that, in 1990, received over $17.5 million in dividends from the non–resident, was not required to file the T106 information return.

2.58 In our view, it is reasonable to conclude that hundreds of millions of dollars in tax revenue have already been lost and will continue to be at risk.

2.59 In the view of the Department of Finance, it is not possible to quantify how much tax revenue is being lost under the existing regime or to predict whether changing the existing regime would result in any increase in tax revenue. Further, any change in tax legislation would be accompanied by behavioral changes on the part of taxpayers. In their view, taxpayers would attempt to structure transactions in order to avoid any additional tax and, where this was not possible, they could refrain from entering into transactions in the first place. In either case, the Department believes that it is not clear to what extent changing the rules would result in any added tax revenue to the government.

2.60 However, the tax rules on foreign source income and foreign affiliates have now been in place for about sixteen years. We recognize that these problems are complex and that they are not unique to Canada. Nevertheless, the tax base is vulnerable and losses will continue until the issues are resolved.

The tax rules on foreign source income and foreign affiliates have now been in place for about sixteen years. The tax base is vulnerable.

2.61 It is important that the reviews of interest deductibility, foreign source income and foreign affiliates previously announced be completed. When amendments are presented to Parliament, a statement of legislative intent should accompany them to ensure that the government can subsequently be held accountable.

Department's response: *The audit note alleges a number of concerns with respect to the taxation of foreign affiliates and foreign source income. In particular, the Auditor General claims that hundreds of millions of dollars in tax revenue are being lost. This claim is unsubstantiated. The existing foreign affiliate regime accurately reflects the policy intention of Parliament and provides for the taxation of all income that is intended to be subject to Canadian income tax. Moreover, any theoretical revenue gains that might be realized by amending the Income Tax Act would be largely offset as a result of behavioral changes on the part of taxpayers. Specifically, any significant change in the existing rules would likely result in large numbers of businesses moving completely offshore. This would weaken the Canadian economy without generating any additional tax revenue.*

Notwithstanding the fact that the foreign affiliate rules do not result in the revenue loss that the Auditor General claims, in many instances the concerns he raises are ones that are shared by the Department of Finance and that have been the subject of extensive analysis and remedial action over the last several years. This area is, however, one of the most complicated in the Income Tax Act and while it often appears to produce results that are questionable, these results are necessitated by fundamental policy considerations. Accordingly, before commenting specifically on the Auditor General's concerns, it is important to elaborate on some of the basic considerations that must be taken into account in designing a system for the taxation of foreign source income.

Background. *Canada has had to struggle with two conflicting goals. The goal of economic efficiency argues for a system which preserves capital export neutrality. This is achieved when foreign source income is subject to the same effective tax rate as domestic source income, leaving taxpayers indifferent, at least from a tax perspective, as to whether they invest inside or outside of Canada. Conversely, the goal of competitiveness argues for capital import neutrality. This requires that a Canadian investing in a foreign country be subject to tax at the same effective rate as a resident of that country. From a tax perspective, this ensures a level playing field between Canadian and non–Canadian businesses operating internationally.*

In a world where countries maintain different tax systems, it is impossible to achieve both capital import and capital export neutrality. Accordingly, Canada has opted for a system that ensures capital export neutrality with respect to certain types of income and capital import neutrality with respect to other types of income. Specifically, in the case of passive income (i.e., investment income such as interest, dividends and rent) the tax policy concern is that taxpayers will attempt to shelter income in tax haven countries in order to defer the payment of Canadian tax. As a result of this concern, the Income Tax Act contains what are commonly referred to as the Foreign Accrual Property Income (FAPI) rules. The FAPI rules are intended to ensure that passive income earned by certain foreign affiliates is accrued and subject to Canadian tax on a current basis (i.e., annually), thereby eliminating the potential for deferral and hence the tax incentive to shift income offshore.

Conversely, in order to preserve the international competitiveness of Canadian businesses, active business income that is earned offshore by a foreign affiliate is not required to be accrued and is subject to tax only in the foreign jurisdiction. Furthermore, where such income is earned in a "listed country" (basically countries with which Canada has entered into a tax treaty) it may be repatriated (i.e., paid back as a dividend) to Canada on a tax–free basis. The ability to receive dividends from a foreign affiliate on a tax–free basis is intended, at least in part, as a proxy for the foreign tax credit that would have been available to the Canadian company if it had carried on its business through a foreign branch rather than a subsidiary. It also helps to ensure that there is no tax impediment to corporations re–investing their foreign earnings in their Canadian operations.

Finally, in formulating our policy with respect to the taxation of foreign source income, it was necessary to recognize that there are substantial costs inherent in implementing a system that deviates substantially from international norms. As is noted later, such international norms are largely responsible for the policy not to specifically restrict the deductibility of interest on money borrowed to invest in a foreign affiliate. Ultimately, Canada finds itself in the position of having to balance tax theory with the economic realities of the international marketplace. To a large degree, international norms limit the range of options available to the Canadian government and, in this context, the government's policy has generally been to favour competitiveness concerns over those of revenue generation. Nonetheless, the Department of Finance continues to study those rules relating to the taxation of foreign source income, both in Canada and in other countries, with a view to ensuring that the Income Tax Act produces results that are fair overall and maintain a reasonable balance between competing policy objectives.

Tax avoidance. *The audit note begins by making some general observations on the inappropriateness of tax avoidance, with the underlying implication that the problem of tax avoidance in the foreign affiliate area has not been properly addressed.*

However, the note ignores the fact that numerous amendments to the foreign affiliate rules have been implemented over the last several years. As well, given the creativity of taxpayers in devising new avoidance transactions, it is frequently impossible either to anticipate a particular avoidance scheme or to specifically legislate against it. It was against this background that the General Anti–Avoidance Rule (GAAR) was introduced into the Income Tax Act — effective for 1988 — in order to provide Revenue Canada with the legislative tool necessary to deal with unanticipated tax avoidance. While GAAR is still *relatively new, it is anticipated that Revenue Canada will apply it on a regular basis in those cases which involve abusive tax avoidance. Rather than attempting to attack each avoidance scheme, a general anti–avoidance rule is a much more useful tool to deal with avoidance transactions. In the short time since its introduction the professional community has found it to be a matter that must be taken into consideration in any tax planning format.*

Interest deductibility. *The principal concern raised in the note is that a Canadian resident who borrows money in order to acquire shares in a foreign affiliate will, subject to the general rules regarding interest deductibility, be able to deduct the interest on the borrowed money as an expense, even though the income earned by the foreign affiliate may not be subject to Canadian tax on a current basis and, in many cases, may be repatriated to Canada tax–free.*

While this clearly gives rise to a mismatching of income and expenses, it is important to note that, at least historically, it also represents the international norm. Departing from this norm (i.e., denying Canadians a deduction for interest when, in similar circumstances, other countries would permit an interest deduction for their residents) would have a significant impact on Canada's international competitiveness and, ultimately, could result in a considerable number of Canadian businesses either moving offshore or being forced out of foreign markets. Moreover, it is not always appropriate that the expenses related to a particular investment be deductible only against the income from that investment. For example, where an investment generates losses, such a narrow approach would have the effect of denying taxpayers a deduction for legitimate business expenses and would represent a significant disincentive for Canadians to invest in new ventures. Finally, the ability to repatriate certain income on a tax–free basis is intended both as a substitute for allowing a foreign tax credit in respect of the foreign source income and to eliminate any tax impediment to corporations reinvesting their foreign earnings in their Canadian operations.

Consequently, while the government continues to monitor developments in other countries, it has refrained from making changes that would have the potential to damage Canada's international competitiveness. As was indicated earlier, the exact balance to be struck between capital export and capital import neutrality is not easily achieved. In this regard, Canada — in keeping with most industrialized countries — has chosen to encourage international competitiveness at the expense of revenue generation. Where, however, technical anomalies with the existing rules are identified, they are dealt with on an ongoing basis.

Exempt dividends from foreign affiliates. *The audit note criticizes the fact that dividends from Canadian corporations qualify for the dividend tax credit even when they are paid out of foreign source income that has not been subject to either Canadian or, in many cases, foreign income tax. The note also observes that although the ability to receive dividends on a tax–free basis ("exempt dividends") was intended as a substitute for a foreign tax credit system, exempt dividends may be received from a foreign affiliate even where the affiliate is based in a tax haven country and therefore is effectively not subject to any foreign tax. In this regard, the Auditor General has provided a number of examples of ostensibly abusive transactions and concludes that hundreds of millions of dollars in tax revenue are being lost.*

The availability of the dividend tax credit is fundamental to the elimination of double taxation. This goal is equally appropriate in the context of

Canadian as well as foreign source income. The ability of foreign affiliates to pay out exempt dividends also represents a strong incentive for other countries to enter into treaty negotiations with Canada, further contributing to the elimination of double taxation generally.

Furthermore, the dividend tax credit is as much an inducement to invest in the equity of Canadian companies as it is a credit for taxes paid at the corporate level. Given this, the precise composition of a corporation's income is irrelevant. Under the Canadian tax system, earnings are not segregated by source. Rather, funds are co–mingled and the dividend tax credit is available in respect of all earnings, regardless of the amount of underlying tax which may have been paid by the corporation. On a practical level, eliminating the dividend tax credit for dividends paid out of foreign source earnings would simply result in corporations paying dividends only out of their Canadian source earnings. Moreover, based on the examples in the note, there is no indication of the extent, if any, to which exempt dividends received from foreign affiliates are flowed out to Canadian taxpayers, who are eligible for the dividend tax credit. Accordingly, there is no evidence that the availability of the dividend tax credit in respect of foreign source income represents a serious problem.

With respect to the ability of corporations to receive exempt dividends from foreign affiliates based in "designated countries" that are tax havens, historically Canada's policy was to designate countries once we had entered into tax treaty negotiations with them. In some instances, although negotiations were commenced, no treaty was ratified. Notwithstanding this, certain countries continued to be designated in the expectation that a tax treaty would be entered into at a future date. Since the early 1980s, however, Canada has had a general policy of neither designating, nor entering into tax treaties with, countries that are considered to be tax havens. Difficulties arise, however, where a country introduces tax preferences into its law only after it has concluded a treaty with Canada. In this respect many countries that introduce such tax preferences are really no different from Canada, which also offers limited tax preferences in order to stimulate certain sectors of the economy.

The Department of Finance is, however, currently considering a number of proposals to address these issues. In particular, the list of designated countries is continually under review as a result of changes to our treaty network, with a view to adding new countries with which tax treaties have been entered into and removing countries with which tax treaties are not in effect. In addition to this, the Income Tax Act and Regulations contain several provisions to ensure that income earned in tax haven countries cannot generally be brought back to Canada tax–free. Where there is a concern that a foreign affiliate based in a tax haven country has attempted to circumvent these rules, the arrangement should be attacked by Revenue Canada on the basis of either the specific rules in the Income Tax Act or GAAR.

***Taxable dividends from foreign affiliates.** The audit note observes that even where a foreign affiliate is not able to pay exempt dividends, an incentive may exist to defer distributing income in order to postpone paying Canadian tax. The note also provides a number of examples of instances in which the foreign affiliate rules may have been circumvented.*

Once again, the appropriate policy response to the issue of deferral necessitates weighing the desirability of capital export neutrality against that of capital import neutrality. Thus, in those situations where it is reasonable to conclude that the principal reason for earning or *retaining income in a foreign affiliate is to avoid Canadian tax, the FAPI rules are intended to ensure that the income is accrued and subject to tax on a current basis in Canada. Where, however, there are legitimate business reasons for the income being earned or retained offshore, competitiveness concerns dictate that it should be taxed only when it is brought back to Canada.*

Other related problems. *The FAPI rules, which are designed to prevent taxpayers from sheltering investment income offshore, drive off the distinction between active and passive income (with only the latter being subject to tax on an accrual basis). The audit note criticizes the lack of any definition as to what constitutes active and passive income. The audit note also puts forth a list of examples to demonstrate the apparent ease with which tax avoidance occurs.*

Although the Income Tax Act does not define active and passive income, the policy underlying these concepts is well understood by the business community. The terms have also been commented on extensively by the courts and the principles underlying their characterization are well established. Given this, there is little foundation for the Auditor General's comment that "there is no reasonable assurance that the rules will apply in circumstances where they should".

The examples cited by the note are misleading. In many instances the income involved would appear to constitute FAPI and, as such, would be accrued and subject to tax in Canada on a current basis. In addition to this, many of these examples would also seem to involve transactions which could be attacked by Revenue Canada, under either the specific anti–avoidance provisions of the Income Tax Act or GAAR. Consequently, the claim that hundreds of millions of dollars in tax revenue are being lost is not supported by the examples and is unfounded.

Conclusion. *While the Auditor General has identified a number of concerns with respect to the operation of the foreign affiliate rules, he has failed to indicate that most of these concerns are the result of conscious policy decisions on the part of the government and reflect a desire to promote the goal of international competitiveness. Moreover, he has also overstated the impact of the rules on revenue collection while understating the degree to which any problems have already been addressed by existing legislation. It would not be prudent to implement a system for the taxation of foreign source income which deviates substantially from international norms and fails to properly address the issue of competitiveness. In this regard, the economic costs inherent in amending the income tax legislation to accommodate the Auditor General's ostensible concerns would far exceed any marginal revenue gains that might be realized thereby.*

Department of Industry, Science and Technology

Non–compliance with Government Contracts Regulations and payment to an operating agency resulted in avoidance of a lapsing of funds

The Prosperity Secretariat in the Department of Industry, Science and Technology entered into 22 contracts worth $3.3 million on a "non–competitive" basis that, in our opinion, were not in compliance with Government Contracts Regulations. The Department also paid $2.5 million to an Operating Agency resulting in an avoidance of a lapsing of funds in 1991–92. This note is based on an audit of all contracts entered into by the Prosperity Secretariat. We undertook the audit to determine whether the contract activities of the Prosperity Secretariat followed the Government Contracts Regulations and the Financial Administration Act.

Non–compliance with Government Contracts Regulations

2.62 **Background.** The objective of government procurement contracting is to acquire goods and services "... in a manner that results in best value or, if appropriate, the optimal balance of overall benefits to the Crown and the Canadian people."

2.63 Further, the government's policy on procurement contracting states that "contracting shall be conducted in a manner that will "stand the test of public scrutiny in matters of prudence and probity, encourage competition and reflect fairness in the spending of public funds".

2.64 The competitive bidding process applies to all contracts unless the circumstances meet one of four criteria:

- the need for the services is one of pressing emergency in which delay would be injurious to the public interest;
- the estimated expenditure must be less than $30,000;
- the nature of the work is such that it would not be in the public interest to solicit bids; or
- only one person or firm is capable of performing the contract.

One of the objectives of the Prosperity Secretariat is to improve Canadian competitiveness.

2.65 When a contract proposal fails to meet at least one of these criteria, a department must obtain an exception to the regulations by means of an order–in–council before entering into a non–competitive contract.

The Prosperity Secretariat entered into 22 non–competitive contracts.

2.66 **Issue.** On 24 May 1991 Treasury Board approved the creation of an interim Prosperity Secretariat to pursue Cabinet consideration of the proposed Prosperity Agenda and timetable. It has a two–year budget of $21.6 million. One of its objectives is to improve Canadian competitiveness domestically and internationally.

2.67 The Prosperity Initiative was publicly launched on 29 October 1991. Among other things, the aim of the initiative was to conduct about 200 public consultation meetings at the community and regional levels (the "Community and Regional Talks") starting in fall 1991. To conduct this and other work the Prosperity Secretariat verbally entered into 22 non–competitive contracts ranging in value from $35,000 to $743,000, for a total of $3.3 million. These legally binding verbal contracts were subsequently confirmed by the Department of Supply and Services in written contract form.

2.68 In entering into these 22 non–competitive contracts, the Prosperity Secretariat did not follow the Government Contracts Regulations. The Treasury Board Manual interpretation of the regulations permitting non–competitive contracts states, "Emergencies are normally unavoidable and require immediate action which would preclude the solicitation of formal bids. An emergency may be an actual or imminent life–threatening situation, a disaster which endangers the quality of life or has resulted in the loss of life, or one that may result in significant loss or damage to Crown property." None of the Prosperity Secretariat's contracts for public consultations entailed an "emergency" as defined by the Treasury Board Manual. The three other exception criteria in the regulations also were not met. All 22 contracts were in excess of the $30,000 exception limit and were for work directly related to public consultation and communication conducted by a number of different persons and firms.

2.69 **Conclusion.** In our opinion, the Prosperity Secretariat did not meet any of the criteria for entering into non–competitive contracts as stated in the Government Contracts Regulations, and an exception to the regulations was not obtained by means of an order–in–council.

Payment to an Operating Agency resulted in avoidance of a lapsing of funds

2.70 Background. In February 1992 the Prosperity Secretariat in the Department of Industry, Science and Technology received Cabinet approval for a $2 million expenditure to cover the cost of a four-week advertising campaign between 15 February and 15 March 1992. On 27 March the Department signed a $2 million agreement with Canada Communications Group (CCG), an Operating Agency in the Department of Supply and Services, for this advertising campaign. Industry, Science and Technology paid $2 million to CCG before the end of the 1991–92 fiscal year. It also authorized CCG to allocate to this agreement an additional $521,000 in unspent funds from a previous contract. CCG operations are financed by a non–lapsing Supply Revolving Fund of DSS.

2.71 The advertising campaign did not take place until the following fiscal year. Industry, Science and Technology's rationale for payment in 1991–92 was contained in a handwritten addendum to the agreement, stating "the funds are required immediately so that media space can be purchased now in order to secure significant discounts".

2.72 Issue. The Department of Industry, Science and Technology's agreement with CCG stated that the costs involved were for fiscal year 1992–93 and that the Department agreed to be invoiced immediately for payment in fiscal year 1991–92. In our opinion, the payment in 1991–92 was in advance of need. The Department's rationale was that significant discounts in the purchase of media space would result. The agreement with CCG, however, was for the production of several television commercials and printed material in tabloid format. It did not involve purchase of media space except for one television contract. We found that no discounts were obtained on the contracts for either production or media space.

2.73 The Financial Administration Act permits advance payments to be made if such an advance is stipulated in the contract. In our opinion, however, there was no need for such a stipulation in this agreement since CCG did not make any advance payments to the suppliers in fiscal year 1991–92 and no discounts were obtained.

2.74 Conclusion. In our opinion, Industry, Science and Technology's payment from a lapsing vote to a non–lapsing Supply Revolving Fund of DSS resulted in avoidance of a lapsing of 1991–92 funds. The $2.5 million payment did not involve any discount and, consequently, there was no saving to the Crown.

The Department of Industry, Science and Technology's payment from a lapsing vote to a non–lapsing Supply Revolving Fund resulted in avoidance of a lapsing of 1991–92 funds.

Department of Industry, Science and Technology's response: Non–Compliance with Government Contracts Regulations. *The Prosperity Secretariat was established on 14 June 1991 on an interim basis for the 1991–92 and 1992–93 fiscal years. The Secretariat was tasked to organize and carry out a comprehensive consultative process, including community consultations which were held in 186 rural and urban centres across Canada, a series of national consultations with Canadian opinion leaders in the business, labour, academic, aboriginal and social action communities, as well as discussions with other federal government departments and agencies and provincial governments.*

A detailed operational plan was developed to ensure that this consultative process would fit within the timeframe established by the government to produce, by the fall of 1992, an Action Plan on the future prosperity of Canada. It was recognized from the start that the operational plan would require continuous updating and that the Secretariat would have to retain flexibility in its operations to meet last minute changes. Consequently, it was *not always possible to enter into a competitive bidding process in contracting out certain of its workload and still meet the deadlines to produce results which would be both useful and timely.*

Transfer of Funds to an Operating Agency Resulted in an Avoidance of a Lapsing of funds. *During the contract negotiations, the Department received a written confirmation from CCG that advance payments would facilitate their negotiating of discount prices on media buys. Subsequently, we entered into a contract with CCG which stipulated that an advance payment be made. We then executed the contract in accordance with its terms and conditions.*

Department of Supply and Services' response: *The transition of the Canada Communications Group to a Special Operating Agency has afforded the opportunity to review business and accounting practices so that both probity and profitability are effectively accommodated. Clearly the situation referred to by the Auditor General arose as a result of a misunderstanding, which the review of business practices will endeavour to ensure does not occur again.*

Department of National Health and Welfare

Failure of management controls over project contracting

Project managers failed to properly administer contracts valued at $5 million during the planning phase of the Income Security Programs redesign project. Over a period of two years there was repeated disregard for the controls in place to safeguard public funds. The Department's program and financial managers did not exercise effective control over this phase of the project.

Internal audit found that 22 contracts out of the 23 examined were not managed in full accordance with all applicable legislative and other requirements.

2.75 Background. Paragraphs 2.114 to 2.125 of our 1991 Report described an instance where certain managers in the Department of National Health and Welfare (NHW) acted beyond their authority and breached numerous policies and directives that were in place to control the management of cash, contracting, travel and financial–reporting practices. Our observations were based on the results of a departmental internal audit.

2.76 The instance involved the Income Security Programs (ISP) redesign project. This is a multi–year undertaking to plan, define and implement a new integrated client delivery system for the Old Age Security, Canada Pension Plan and Family Allowances programs. The ISP redesign project will extend to 1997 at a total estimated cost of $258 million.

2.77 The Deputy Minister of National Health and Welfare requested that a second internal audit be carried out to review contract administration generally, within the ISP redesign project. The audit scope included all service contracts over $10,000 that had been entered into during the planning phase of the project. These contracts, totalling $5.6 million, were reviewed for compliance with Treasury Board and Department policies on contracting and other financial management practices. The audit was completed in January 1992 and the report was dated May 1992.

2.78 Our observations below are based on the findings contained in the second internal audit report. As required for purposes of reliance, we completed a review of the supporting audit files and satisfied ourselves that the work was carried out in accordance with appropriate professional standards. We are reporting the results of this internal audit because of the extent and seriousness of the breaches of control, and also because of the size and importance of the overall ISP redesign project.

2.79 Issue. The internal audit found that 22 contracts out of the 23 examined were not managed in full accordance with all applicable legislative and other requirements. There was repeated disregard for the Financial Administration Act, Government Contracts Regulations, Treasury Board policies and directives and the Department's own policies and procedures. In short, there was a general and widespread breakdown of management controls, including fundamental parliamentary controls, during the planning phase of the ISP redesign project.

2.80 The timing of these actions raises another serious concern. In responding to the earlier internal audit, referenced in our 1991 Report, senior ISP Branch management stated that steps had been taken in the fall of 1990 to strengthen the contract review process. However, the second internal audit found that breaches of contracting and other financial controls were occurring well into 1991. Clearly, any initial steps taken to correct the situation were ineffective.

2.81 Parliament has assigned responsibility for the control and spending of public money to ministers and deputy heads through appropriation acts, the Financial Administration Act (FAA) and regulations made under that Act, such as the Government Contracts Regulations. Through the written delegation of financial signing authorities, these responsibilities are delegated by ministers and deputy heads to appropriate managers in departments. The intent is to delegate to managers who can execute the responsibility most effectively, and where accountability for results can best be exercised. Some examples of where and how this control framework failed follow.

2.82 The second internal audit found that on numerous occasions ISP redesign project managers exceeded their expenditure initiation authority, either directly or through contract splitting. Contract splitting kept the value of individual contracts within the delegated signing authority limit and, in some cases, below the Department's limit on sole–source contracting set by Treasury Board. These practices do not comply with the Government Contracts Regulations.

2.83 One instance involved an arrangement in early 1990 to acquire training services which provided for a payment of more than $350,000. The amount exceeded both the project managers' and the Department's overall authority for expenditure initiation. It also exceeded the limit beyond which the Department of Supply and Services must be involved in the contracting process. There was no evidence that bids from other suppliers were solicited and no sole–source justification document was prepared. Although no contract was prepared for this arrangement, payment was made.

2.84 Another important control is the certification of contract performance and price — FAA section 34. Managers with delegated authority certify that goods and services have been delivered in accordance with contractual terms and conditions. The internal audit found that ISP redesign project managers requested certain suppliers to submit invoices before year end for work that had not been completed. These invoices were then improperly certified by project managers pursuant to the FAA section 34, and payment authority, FAA section 33, was later granted by the Department's Accounting Operations Division. The audit concluded that, contrary to FAA Section 37, the funds had been prepaid to avoid their lapsing at 31 March.

2.85 In all, invoices totalling $446,000 were discovered to have been pre–billed at the request of ISP redesign project managers, and paid before the work was completed. The contracts did not call for advance payments, the advanced funds did not earn interest for the Crown and the funds were not protected by performance bonds. The audit also reported that invoices had been paid even though the rates charged were not in accordance with the written contracts.

There was a general and widespread breakdown of management controls.

There is a need for a much stronger management control framework for the Income Security Programs redesign project.

2.86 Conclusion. The internal audit report reveals serious deficiencies in contracting and payment for services related to the planning phase of the ISP redesign project. The numerous instances of non–compliance show a disregard by managers for the controls that are in place to safeguard public funds, and demonstrate a lack of due regard to prudence and probity.

2.87 The ISP redesign project is still in its early stages. In our view, the repeated disregard for fundamental controls shown by the project managers and, more important, the failure of the Department's program and financial managers to correct these activities during the planning phase, indicate the need for a much stronger management control framework as the project progresses.

Department's response: *The problems described by the Auditor General were recognized by ISP Branch management over a year ago. A new management control framework was in place by October 1991 with specific emphasis on strengthened contracting processes. Branch management is not aware of any serious deficiencies since that time.*

The weaknesses in contracting practices occurred primarily in the ISP redesign project office. The work by departmental internal auditors provided more details about the exact nature of the failures in the contracting process and their report has been referred to the Royal Canadian Mounted Police for consideration. Therefore, the Department cannot comment on any of the details.

Department of National Health and Welfare

Payment of benefits to recipients who are no longer eligible results in significant overpayments in the Canada Pension Plan Disability Program

The Canada Pension Plan Act requires that an individual "have a severe and prolonged mental or physical disability" to be eligible for a disability pension.

Insufficient attention is directed to the reassessment of eligibility for Canada Pension Plan disability benefits. Although the results of existing verification activities indicate a significant level of payment to ineligible recipients, there is no systematic approach to reassessment. Annual overpayments of up to $65 million will continue until the reassessment process is improved and the required resources are allocated to this activity.

2.88 Background. The Department of National Health and Welfare (NHW) administers the Canada Pension Plan (CPP) program through its Income Security Programs Branch. The CPP Act provides for the payment of disability pensions to eligible CPP contributors and for the payment of benefits to their dependent children. A disability benefit is made up of a flat–rate portion plus 75 percent of the amount of the contributor's retirement benefit. The maximum monthly payment in 1992 was $784. During 1991–92, almost 224,000 disabled beneficiaries and 70,000 dependent children received payments totalling $1.8 billion.

2.89 To be eligible for a disability pension, an applicant must be disabled according to the terms of the CPP Act. The Act requires that an individual "have a severe and prolonged mental or physical disability". Severe is defined as "incapable regularly of pursuing any substantially gainful occupation"; only earnings income affects eligibility. Prolonged means that "the disability is likely to be long continued and of indefinite duration or is likely to result in death".

2.90 The CPP Regulations include a provision for the reassessment of eligibility for disability benefits; specifically, that it may be required "from time to time". The Department defines reassessment as a regular and pre–planned review of recipients' ongoing eligibility. The objective is to identify and stop payment on accounts where beneficiaries no longer meet the eligibility criteria.

2.91 We became aware of problems associated with the reassessment of eligibility for disability benefits during our regular CPP audit work, and pursued the issue concurrent with our audit of NHW seniors' programs (to be reported in 1993). The disability portion of the CPP is not seniors–related as benefits are paid only to those under 65 years of age. We are reporting this matter now because of the need for prompt action to address the ongoing high level of overpayment.

2.92 **Issue.** We expected to find that the Department's policies and procedures would ensure that disability benefits were paid only to those who continued to be eligible due to a severe and prolonged disability. We found that this was not the case.

The Department's policies and procedures do not ensure that disability benefits are paid only to those who continue to be eligible due to a severe and prolonged disability.

2.93 The Department describes its reassessment processes as cumbersome. There is a lack of EDP support, and some policies and procedures are not formalized. For example, there is no formal policy establishing the level of earnings that will result in cancellation of disability benefits. Furthermore, the current reassessment activities are neither consistent nor timely.

2.94 There is a reassessment questionnaire that can be mailed to disability beneficiaries (9,000 in 1991–92) for a variety of reasons. It includes questions on medical condition, on earnings and on other types of disability benefits received. There is a follow–up to ensure that all questionnaires are returned; a beneficiary's failure to do so may result in the immediate cancellation of benefits.

2.95 We were informed, however, that reassessments using the returned questionnaires are performed only as resources permit. In recent years, to cope with increases in the number of clients and demand for service, priority has been given to processing new applications. As a result, reassessments are carried out only when essential, such as when a beneficiary submits new information about employment.

2.96 In early 1988, a project was undertaken to identify disability recipients who have not disclosed significant employment earnings. All active disability accounts were compared to the CPP record–of–earnings file. This comparison identified 31,000 beneficiaries with post–entitlement earnings. Between March 1989 and March 1991, 4,600 of these accounts were selected for reassessment, and benefits were subsequently cancelled for one in ten. Of these, 360 were found to be no longer disabled, and overpayments of $8 million were recorded.

2.97 Project results also disclosed that 80 percent of the 4,600 cases had not been reassessed since being granted disability benefits, some going back to 1980–81. The project report concluded that ongoing maintenance of a reassessment program for accounts identified with earnings would prevent substantial mispayments to beneficiaries who are no longer eligible. Although there is now a quarterly earnings match carried out, we were told that resources have not been available to investigate these accounts.

2.98 In a 1991 Treasury Board submission, the Department projected savings of $1.2 billion over the nine–year period to 2000–01 related to the establishment of a new disability reassessment program. Recently, a two–year, $10 million project was established to develop and implement a new disability reassessment process. The scope of this project will include the reassessment function's organization, business processes, systems and procedures, and training of staff. One of the anticipated benefits of the project is reduced overpayments.

2.99 The Department has received a consultant's report that contains a more conservative projection of $730 million in savings over the same period. The preliminary data indicated that, with proper screening and pre–selection methods, benefits could cease in 30 to 35 percent of accounts reassessed. However, it is unlikely that significant benefits from the current project to develop new reassessment processes will be realized before 1994–95, representing two years slippage from the original plan. In the meantime, the high rate of overpayment to disability beneficiaries who are no longer eligible will continue, resulting in a sizable loss to the CPP account. Current annual overpayments are estimated by the Department to be up to $65 million.

Disability reassessment activites have been insufficient for many years, although the Department has evidence that large amounts of money are being paid to ineligible beneficiaries.

2.100 Conclusion. Disability reassessment activities have been insufficient for many years now, although the Department has good evidence that large amounts of money are being paid to ineligible beneficiaries. In our view, the action taken to address this situation has been inadequate for both ongoing reassessment activities and timely development of improved assessment processes.

2.101 As administrator of the CPP, the Department has a responsibility to manage its operations, including disability reassessment, in the most cost–effective manner, to the benefit of the Plan's contributors and beneficiaries. The Department should take immediate steps to deal with the backlog of returned questionnaires and earnings information awaiting reassessment action. The new reassessment process under development should, in addition to developing reassessment selection criteria for new applicants, include measures to identify existing cases for high–priority reassessment.

Department's response: *Although the development of revised reassessment processes has been slower than anticipated, improvements to questionnaires and other forms were introduced in January 1992. At the same time, the Department has recognized that disability reassessment processes need to be improved to cope with a significant increase in workload and is making substantial investment in this area as one of the components of the income security programs redesign project. This major Crown project is in its project definition phase. Other options for immediately targeting the reassessment backlog are being actively considered, within resource constraints.*

Department of National Revenue – Taxation

Unauthorized tax exemption for interest earned by condominium corporations

An assessing practice not authorized by the Income Tax Act allows condominium corporations to earn tax–free interest income for the benefit of their membership, the individual condominium owners. This tax exemption is not available to homeowners generally, and violates the principle that the right to tax rests with Parliament, through the legislative process.

2.102 Background. In an administrative arrangement not authorized by law, described in Information Circular No. 79–7 (which excludes Quebec), the Department of National – Taxation allows condominium corporations to earn tax–free interest on the money they set aside in operating and reserve funds to pay certain maintenance expenses. Condominium corporations regulate the use of the condominium property and provide repairs to the common areas and other services to the owners.

2.103 The only limitation is that the operating and reserve funds cannot be maintained at an "unreasonably high" level in relation to the purpose for which they were created. The Department, however, provides no interpretation of "unreasonably high".

2.104 Issue. The tax exemption for interest earned on a condominium corporation's operating and reserve funds indirectly benefits the condominium owners. Homeowners not living in condominiums must pay tax on any interest earned on funds set aside for maintaining their homes. This situation creates an inequity between homeowners who own condominiums and those who own other types of residential dwellings. Furthermore, because this assessing practice is not authorized by the Income Tax Act, it violates the fundamental principle that the right to tax rests with Parliament, through the legislative process.

***Department's response:** Condominiums are set up not to make a profit in the long run but to maintain the common elements of the condominium. Information Circular 79–7 was drafted to address issues raised by provincial laws which differed between provinces and were still developing.*

The Department is studying the status of these condominium corporations in light of current provincial laws and will update its Information Circular accordingly.

Departments of National Revenue – Taxation and Finance

Excessive claims for Investment Tax Credits

An opportunity exists for taxpayers to claim excessive Investment Tax Credits by inflating the value of their used equipment given as a trade–in on the purchase of new machinery.

2.105 Background. The Investment Tax Credit (ITC) is calculated as a percentage of the capital cost of specific qualifying assets — essentially new machinery — to be used in activities including farming, fishing, forestry, manufacturing, construction, producing oil and gas, and mining. These credits are fully deductible against tax otherwise payable. In the early 1980s, the Department of National Revenue — Taxation (NRT) identified a tax avoidance situation involving excessive claims for Investment Tax Credits. Taxpayers who were purchasing new equipment where a trade–in was involved were structuring the transactions to increase the capital cost of the purchased equipment, resulting in an ITC overallowance. Although Investment Tax Credits were significantly reduced after 1988, they are still earned on qualifying assets in the Maritimes and offshore regions, and on research and development expenditures throughout Canada.

2.106 Beginning in 1982, NRT took the following steps:

- A national audit project was undertaken with the support of the Department of Finance to determine the extent of the problem and any potential abuses of the ITC program.
- Over 1,400 cases involving ITC overallowances were identified, with a majority located in the western farming industry.
- NRT reassessed only those cases where the value of the trade–in equipment was inflated more than $30,000 above its fair market value.

The Department of National Revenue – Taxation identified a tax avoidance situation involving excessive claims for Investment Tax Credits, and over 700 cases were reassessed.

Exhibit 2.2

Example of an Investment Tax Credit Overallowance

	Purchase Structured for Tax Purposes	The Substance of the Transaction
Purchase price of new tractor		
Including overallowance for old tractor	$ 125,000	
Excluding overallowance for old tractor		$ 65,500
Less trade–in of old tractor		
Fair market value of old tractor	$ 45,000	$ 45,000
Overallowance for old tractor	59,500	
Trade–in amount received on old tractor[1]	104,500	45,000
Amount paid in cash	$ 20,500	$ 20,500
Investment Tax Credit		
7% of $125,000	$ 8,750	
7% of $65,500		$ 4,585
Investment Tax Credit Overallowance [$ 8,750 – $4,565]	$ 4,165	

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[1] The trade–in amount received for the cld equipment may be greater than its original purchase price when new.

- Over 700 cases were reassessed for the 1984 to 1986 taxation years.

2.107 A test case on these overallowances was taken to the Tax Court of Canada, but the decision, rendered on 23 April 1991, went against NRT (Zeiben v. Minister of National Revenue). Although the Department of Justice filed an appeal, it was discontinued four days later on instructions from NRT. It is unclear why the appeal was discontinued. The Department of National Revenue – Taxation has decided to apply the Tax Court decision for the benefit of all 700 taxpayers who were reassessed in respect of trade–in allowances on farm equipment. The Department obtained a remission order to return approximately $5 million dollars of federal income taxes, CPP contributions and interest paid by these taxpayers. Taxpayers who claimed the fair market value of their trade–ins for Investment Tax Credit purposes, in accordance with generally accepted accounting principles, will not benefit from the remission order.

An opportunity now exists for taxpayers to inflate the trade–in value of used equipment and thereby increase the capital cost of their new equipment purchases.

2.108 **Issue.** An opportunity now exists for taxpayers to inflate the trade–in value of used equipment and thereby increase the capital cost of their new equipment purchases. This enables taxpayers to increase their Investment Tax Credits and avoid tax. This situation also creates an inequity between those taxpayers who buy equipment only with cash and those who buy with cash and a trade–in of their used equipment.

Department of National Revenue – Taxation's response: *The Tax Court found that the contract of purchase and sale between the parties was the major item of evidence and it had not been discredited to warrant it being rejected. Although generally accepted accounting principles (GAAP) provide that the basis for the valuation of a new asset acquired in a trade–in transaction is the fair market value of the consideration given in exchange, the Court was not convinced that the jurisprudence regarding GAAP went as far as to reject the amounts agreed to by the parties in a bona fide contract.*

It was decided not to appeal the decision on the basis of the facts of the particular case, which is limited in its application, and will, therefore, not impact the remaining investment tax credits, i.e. the regional and research and development tax credits. Also, since tax reform, there is a general anti–avoidance rule in place that will serve to prevent any abuse.

A number of cases in the same business sector with identical fact patterns were outstanding, pending the resolution of the case, and it was decided to accept those where appeals had been filed. In addition, there were a number of other cases in the same business sector who had not protected their rights by appealing. With respect to those cases, a remission order was recommended and approved.

Department of Public Works

Lack of due regard to economy in the lease–purchase agreement for the Louis St. Laurent Building

In September 1991 the Department of Public Works (DPW) entered into a 25–year lease with a purchase option (the "lease–purchase agreement") for the Louis St. Laurent Building in Hull, Quebec. The annual payments are based on the negotiated value of the property, $73 million. We found that:

- *DPW entered the lease–purchase agreement based on an unspecified term of requirement and without due regard to economy;*
- *DPW did not consider the income tax implications arising from the lease–purchase of the Louis St. Laurent Building; and*
- *the government's method of accounting for capital acquisitions may have contributed to a real property investment decision that was not economical.*

- *The last two findings have broader application to other real property investments undertaken by the government.*

2.109 Background. In October 1983, Treasury Board gave DPW approval to acquire office space in a building still to be constructed (the Louis St. Laurent Building) through a 10–year lease, and to consider a purchase provision in the lease as a long–term option. DPW could not negotiate the purchase option but did obtain a 10–year lease.

2.110 Construction of the building was substantially completed in 1985 at a cost of $41.5 million (including land), according to audited financial statements. It contains about 40,800 square metres of office and storage space, for which the gross annual rent was about $9.6 million under the original 1985 lease.

2.111 The building houses some 2,150 personnel from the Department of National Defence (DND), or 18 percent of the Department's headquarters staff. The Department of National Defence has been the sole tenant of the building since June 1985.

2.112 During the period December 1990 to May 1991, the landlord made a number of unsolicited proposals to DPW to renegotiate and extend the term of the existing lease, due to expire in May 1995. The proposals included options for a new lease with terms ranging from 10 to 25 years; the Department of Public Works rejected those proposals on the basis of price.

2.113 In May 1991, having been unsuccessful in negotiating a renewal of the lease with the landlord, DPW proposed a lease–purchase arrangement based on the appraised market value of the building. This approach culminated in a contract that was signed on 30 September 1991.

2.114 The contract contains the following main provisions:

- The term runs for 25 years, starting 1 August 1991.
- Rental payments are based on a 25–year amortization of $73 million. For the first five years, annual payments are about $8.4 million. Future payments are based on the landlord's cost of refinancing the outstanding balance. The Crown retains the right to approve financing rates and terms.
- The Crown has an option to purchase the building at the end of the 25–year term for $15 million (estimated by DPW at $1 million in 1991 dollars).
- The Crown is responsible for all costs (estimated by DPW at about $3.4 million per year) of operating and maintaining the building, including structural repairs.
- The landlord will manage the building for 25 years for an annual fee, subject to indexing, of $89,500 plus $70,000 for salaries.

2.115 In legal terms, title to the Louis St. Laurent property rests with the landlord. However, this agreement transfers substantially all the benefits and risks of ownership to the Crown. That is, by definition, a "capital lease". In substance, therefore, the agreement represents an acquisition of the property, and DPW has duly reported the transaction as a capital lease in the Public Accounts of Canada.

This agreement transfers substantially all the benefits and risks of ownership to the Crown.

2.116 In summary, the total present value of the lease–purchase package in 1991 dollars is $74 million (the $73 million value on which rental payments are based plus the $1 million present value of the purchase option).

2.117 Issue — DPW entered the lease–purchase agreement based on an unspecified term of requirement. Paragraph 17.94 of the Auditor General's 1991 Report recommended that DPW improve its procedures associated with the planning and acquisition of leased accommodation; this case reinforces the need to act on that recommendation.

2.118 In January 1991, shortly after the landlord and DPW had begun to renegotiate and extend the term of the existing lease, DND said that it was interested in a "further long–term lease" for the building, without specifying the number of years. DPW justified entering into the lease–purchase agreement based on DND's request. According to DND officials, their interest in retaining the space was based on the need to minimize employee disruption until a long–term plan to consolidate their entire headquarters staff (preferably on DND–owned land) could be worked out.

2.119 In March 1992 (about six months after the agreement was signed), DND advised DPW that the Louis St. Laurent Building would become surplus to its needs over the next 10 to 15 years.

2.120 **Conclusion.** In our opinion, DPW's decision to acquire the Louis St. Laurent Building through this lease–purchase agreement was not consistent with DND's long–term accommodation planning. DND is planning to consolidate all headquarters staff at one location within 10 to 15 years, and has said that it will not need the space after that time. We also noted that the Louis St. Laurent Building was not part of DPW's leasing strategy for the National Capital Region.

2.121 **Issue — DPW entered the lease–purchase agreement without due regard to economy.** Construction of the building was completed in 1985 at a reported cost of $41.5 million (including land). According to Statistics Canada, the price index for commercial buildings in the National Capital Region during the period 1985 to 1991 increased by 28 percent. Applying this increase to the Louis St. Laurent Building, the estimated cost to replace it in 1991 would have been $53 million. In early July 1991, two appraisers estimated the building's replacement cost (including land) in the range of $48 million to $64 million. DPW did not explore other building alternatives (such as Crown construction or a lease–purchase agreement with other developers) even though the original lease would not expire until May 1995. This would have allowed about four years to construct a new building for between $48 million and $64 million in 1991 dollars, according to the appraisers' estimates.

2.122 The two appraisers estimated the building's market value at $62 million and $65 million respectively. These appraised values reflected the fact that the government's remaining contractual rent payable under the then existing lease was higher than the 1991 market rent by $6 million to $10 million.

2.123 DPW used the appraised market value of $65 million as the basis for negotiating, as officials believed it was the more defensible appraisal.

2.124 On 9 July 1991 DPW informed the landlord that appraisal reports had been completed, and made its initial lease–purchase offer at the appraised market value of $65 million. After negotiations, DPW agreed on a value of $74 million for the lease–purchase package.

2.125 DPW justified the discrepancy between the appraised market value of $65 million and the negotiated $74 million value on the basis of certain factors. These included the additional value of adjacent land ($1.1 million), painting and carpeting ($1.3 million), money saved through not having to relocate staff and call for tenders ($831,000), and the assumption that a 10 percent variance between the appraised value and the negotiated value was acceptable.

2.126 The $65 million was the appraised market value, whereas the $74 million figure represented DPW's estimate of the value to the Crown. In determining the $74 million figure, DPW included the $9.7 million unamortized value of leasehold fit-ups, which had already been paid for by the government as a condition of occupancy under the original lease.

2.127 The landlord advised us, on 30 September 1992, that, in his view, DPW concluded a reasonable long-term lease with a purchase option agreement for the Louis St. Laurent Building.

In our view, it is difficult to establish a true market value for office space in the National Capital Region when the government occupies approximately 40 to 55 percent of private sector office space.

2.128 In our view, it is difficult to establish a true market value for office space in the National Capital Region when the government occupies approximately 40 to 55 percent of private sector office space. In this case, the difficulty was compounded by the fact that the government was, indeed, the only tenant for the building. One appraiser noted that the property's overall size, large floor plates and relatively isolated location meant that "the only possible tenancy for the Louis St. Laurent Building is the federal government." In effect, the market value evaluations are based on a market created by the government.

2.129 According to DPW officials, the investment options were limited by the government's policy of locating 75 percent of the public service on the Ontario side and 25 percent on the Quebec side of the National Capital Region. In their view, it was unrealistic to think that an alternative building could be found on the Quebec side or that the government would relocate DND employees to the Ontario side.

2.130 **Conclusion.** In our opinion, a number of factors contributed to DPW's weak bargaining position in entering into the lease-purchase agreement for the Louis St. Laurent Building.

- Although the government is the dominant landowner in the National Capital Region, no other available existing building in Hull could accommodate 2,150 public servants.
- DPW claimed that Crown purchase, although the most economical option, was not viable because the owner was unwilling to sell. Other options (Crown construction or a lease-purchase agreement with other developers) were not considered in detail and were not priced out. This was a significant deficiency, in our view, because estimates of replacement cost could have been useful in assessing the acceptability of the landlord's proposals. Instead, the Department did not investigate the cost of constructing a building, disregarded the appraisers' estimates of building replacement cost, and made its initial lease-purchase offer based on the market appraisal of $65 million, the "high end" of the range of estimated values. DPW's view is that the building's replacement cost was not relevant to the negotiations.
- DPW also claimed that a Crown-construct option was precluded by a lack of capital funds and the short lead time (about four years) to plan, get approval for, and construct a building.

2.131 DPW was aware of the risks involved in allowing the Crown to become a "captive tenant" in the Louis St. Laurent Building. In January 1984, the Department wrote to the Treasury Board Secretariat that "the Crown will, if it continues in occupancy beyond the lease term, be greatly disadvantaged financially through the remainder of the occupancy period...".

2.132 In summary, bearing in mind the various estimates of the building's replacement cost and the projected weak market for office space in 1995, we conclude that DPW entered the lease-purchase agreement for the Louis St. Laurent Building without due regard to economy. In addition, as discussed in the following section, there is a possibility that the total cost to the Crown could be significantly higher depending on how the transaction is treated for tax purposes.

Tax implications are particularly important in cases such as this one, in which large sums of money are involved and the transaction is not subject to a competitive bidding process through public tender.

2.133 Issue — DPW does not consider the income tax implications of investments in real property. In commercial real estate transactions, tax implications are important to the parties involved. Usually it is in the landlord's interest to structure a lease–purchase in such a way that, for tax purposes, it is deemed a lease and not a sale. From the Crown's point of view, the tax revenue from a lease–type transaction is most often lower than it would be from a sale.

2.134 In this case, a deemed sale could have resulted in a gain of approximately $32.5 million to the landlord ($74 million less the original construction cost of $41.5 million). The gain could be subject to capital gains tax and would be fully taxed over a five–year period. Furthermore, there could be an additional tax liability resulting from the recapture of any capital cost allowance previously claimed by the landlord.

2.135 If the transaction were deemed a lease, the difference between the rental income and operating costs would be taxed as income over the term of the lease. However, under a lease, a higher capital cost allowance would usually be taken in the early years to defer the income to the later years.

The lease–purchase transaction demonstrates that the government's own practices may contribute to uneconomical decisions in the way office space is acquired.

2.136 According to DPW officials, tax implications are not considered when analyzing and evaluating investment alternatives such as long–term leases or lease–purchase agreements. In the case of the Louis St. Laurent Building, DPW officials said they did not conduct such an analysis.

2.137 Conclusion. In our view, to determine the total cost to the Crown of a real property investment decision, DPW should estimate and take into account the tax implications of various options. Such an analysis could be done using standard assumptions without interfering with the rights of individual taxpayers. Tax implications are particularly important in cases such as this one, in which large sums of money are involved and the transaction is not subject to a competitive bidding process through public tender. Taxation benefits can make a significant difference in tender offers made by developers in public bidding for the provision of space to the Crown.

2.138 Issue — The government's method of accounting for capital acquisitions may contribute to real property investment decisions that are not economical. The lease–purchase transaction demonstrates that the government's own practices may contribute to uneconomical decisions in the way office space is acquired. Under these practices, capital outlays are fully expensed in the year they are made, and added to the deficit of the current year. For lease–purchase agreements, however, the annual costs are added to the government's expenditures each year but only gradually to the accumulated deficit over the term of the lease; in this case, over 25 years.

2.139 Previous reports of the Auditor General have noted that lease–purchase is a costly method of acquiring office space. Paragraph 13.45 of the Auditor's General 1984 Report noted that a developer's borrowing rate is approximately 2 percentage points higher than the government's borrowing rate. Our 1988 Report (paragraph 19.42) noted that acquiring the Government of Canada building in Edmonton, Alberta, through lease–purchase cost almost 20 percent more than the alternative of Crown construction.

2.140 Conclusion. Rental rates are based on the costs of borrowing by the developer. For each percentage point of interest the developer pays above that paid by the government, rents increase by approximately 10 percent. Thus, if the government were to purchase a building outright and finance it at its own borrowing rate, substantial savings could be made.

Department's response: *In situations of fiscal restraint and restricted capital for investment, the lease with option to purchase can provide a practical and advantageous solution to space requirements for the Crown. Historically, lease transactions with an option to purchase have proven to be most advantageous. Examples include the C.D. Howe Building, L'Esplanade Laurier Towers and Les Terrasses de la Chaudière.*

> ***Issue 1, the Department of Public Works entered the lease–purchase agreement based on an unspecified term of requirement.*** *The Department of Public Works (DPW) is mandated to provide general purpose office space to all federal government departments. In fulfilling this mandate, DPW manages an inventory of space, not just a specific building. Space requirements change over time. To best satisfy the short– and long–term operational needs of clients in the most economical manner, DPW continually evaluates options to reduce and eliminate vacancies in facilities it manages.*

The Department of National Defence (DND) indicated a long–term requirement for the space in the Louis St. Laurent Building. While DND subsequently defined its requirement to be for a period of 10 to 15 years, DPW is unaware of any funded plan to replace the space occupied by DND in the Louis St. Laurent Building. In any case, this space will be available to other tenants within the National Capital Region (NCR) in accordance with the NCR leasing strategy.

Issue 2, the Department of Public Works entered the lease–purchase agreement without due regard to economy. *The Department did enter into the lease with an option to purchase agreement for the Louis St. Laurent Building with all due regard for economy and did obtain the best possible agreement given the situation at that time.*

Information available at the time indicated that the recession appeared to be ending, rental rates in Ottawa/Hull were stabilizing, and interest rates were bottoming out. Based on this information, it appeared prudent and practical to entertain the leasing of the Louis St. Laurent Building with the option to purchase in order to solve an outstanding space requirement.

In analyzing the situation, DPW concluded that this was an opportunity for the government to secure in the order of 40,000 square meters of rentable space at an attractive price. This space, which was available in a single block, was seen as a long–term space solution in the Outaouais. DND had expressed a long–term need for space in that quantity. As well, securing this lease with option to purchase enabled the government to maintain the percentages of employees at 25 percent on the Quebec side and 75 percent on the Ontario side of the NCR.

The Department therefore decided to respond to the overtures of the Lessor but first gave itself the advantage by obtaining the Lessor's agreement that the lease price would be based on the value of the property as established by independent appraisers chosen by the Crown.

Issue 3, the Department of Public Works does not consider the income tax implications of investments in real property. *The Department is aware that generally there are tax implications in real property transactions. Although a federal government department, DPW is not privy to the specific tax implications of owners for real property transactions. This information is confidential and known only by the owner and Revenue Canada Taxation. The Department acts as any prudent investor does when transacting in* *real property and relies heavily on the market value of the property in question.*

Issue 4, the government's method of accounting for capital acquisitions may contribute to real property investment decisions that are not economical. *Capital funding restrictions resulting from an environment of fiscal restraint coupled with operational requirements have created the need to enter into lease and lease–with–option–to–purchase agreements.*

The comparison of a lease–with–option–to–purchase agreement to a capital investment provides only one perspective on the merits of the lease with option to purchase. To provide a more balanced perspective, the lease with option to purchase must also be compared to the lease option. Under the lease option, DPW sacrifices the build–up of the equity available under the lease with option to purchase. The Department can share in the equity build–up of the property via the option to purchase at a favourable price. The government thus obtains equity and long range benefits for the taxpayers' dollars.

Department of Fisheries and Oceans

Fishing Vessel Insurance Plan

Background

Deficiencies in management practices have been noted repeatedly over the past 23 years.

2.141 The Fishing Vessel Insurance Plan (FVIP) was established in 1953 by an Appropriation Act, to assist fishermen to meet abnormal capital losses. The current objective of the Plan is to provide insurance coverage and benefits at reasonable rates for all eligible fishing vessels in Canada, while maintaining full cost recovery on operations. While the Plan provides insurance to all eligible fishermen who apply, its *raison d'être* is to make insurance available to those whom the private sector will not insure, such as those using certain types of boats or working in remote areas.

2.142 The Plan is administered by a national headquarters in Ottawa (2.5 person–years) and six regional offices across Canada (38 person–years). Headquarters has functional authority over staff in the regions. At the end of fiscal year 1991–92, there were 6,224 fishing vessels insured, valued at $264 million.

Lack of management action on previous recommendations

2.143 We audited the FVIP as part of our Atlantic Fisheries audit in 1988. We reported:

> Since 1965, numerous reviews and studies of FVIP have been done. Deficiencies in management practices have been noted repeatedly over the past 23 years. We identified many of these same deficiencies in our audit. Although the findings of these past studies were accepted by management and action promised, there was little evidence that the problems were subsequently resolved. In response to our 1977 audit, the Department stated "action has already been taken with respect to many of the observations ... the remainder will be resolved in conjunction with a major review of FVIP now being undertaken." Following a 1985 decision by the Minister against privatization, another study has just been completed and an action plan is now being developed.

2.144 As part of our 1991 follow–up to our 1988 audit, we reported: "The plan [being prepared in 1988 during our audit and in response to the Department's 1988 study] had not been implemented at the time of our follow–up." Accordingly, we decided, in 1992, to audit further to identify and report on the cumulative effect of the Department's lack of action and the continuing existence of many long–standing deficiencies.

2.145 During this audit, officials claimed that much action had been undertaken on the recommendations in the 1988 action plan. We reviewed the implementation of these recommendations, many of which were not new and had also been documented in the previous studies. We found that, although management had initiated action on many of the 32 recommendations, only 7 had been fully implemented. Management states that it now intends to resume implementation of most of the remainder.

2.146 Since 1988, no one individual has been given full–time, permanent responsibility for the management of FVIP. Management functions have been assigned to staff on a part–time and/or temporary basis. This lack of continuity has eroded the corporate memory and contributed to the Department's inability to follow through on its promises of action.

Lack of continuity has eroded the corporate memory and contributed to the Department's inability to follow through on its promises of action.

2.147 A major reason given by departmental officials for the continuing lack of corrective action is their view that the Plan's future has been uncertain. Resources had therefore been diverted to, among other tasks, privatization. The Department states that, in response to the government's consistent commitment to identifying agencies and programs for privatization, it has regularly considered FVIP as a candidate. Since 1984 a number of proposals have been made with a view to "privatizing" — or more accurately "winding up" — FVIP (see Exhibit 2.3 for a listing of key events).

2.148 Whatever their merit, these successive proposals to Ministers for a program wind–up have had the effect of diverting resources away from implementing action plans to solve the many known deficiencies.

Deterioration of performance since 1988

2.149 **Viability of the Plan.** Overall, the financial and business situation of the Plan has deteriorated since 1988. The number of vessels insured has declined by 25 percent and the value insured has dropped by more than 40 percent. Over time the Plan has had surpluses and deficits on operations; however, it has had a growing annual deficit on operations for the last three years, reaching $2.4 million in 1991–92 — or over a third of premiums collected. Finally, the operating expenses as a percentage of premiums collected have also increased since 1988–89 to reach their maximum at 48 percent of revenue in 1991–92. While average premiums received per thousand dollars insured have

Exhibit 2.3

Privatization* Attempts

1. Nov. '84	Announcement by the Minister that FVIP would be privatized by April 1986 as excellent service was considered available from the private sector. This was announced as part of government's commitment to less governmental intervention in the market place.
2. Mar. '85	Announcement by the Minister that FVIP would continue to be managed by the Department and the program would be placed on a self–sustaining basis. This was based on the rationale that the private sector could not guarantee insurance protection to fishermen in all parts of Canada.
3. Sep. '85	Nielsen Report recommended winding up FVIP within three years.
4. Mar. '87	Minister decided that the Nielsen recommendation would not be pursued.
5. Mar. '88	The Departmental Management Committee determined that "the long–term objective remains the privatization of the FVIP."
6. Mar. '89	Strategy for privatizing the FVIP was developed by departmental officials "in the event that the Minister decides to pursue the privatization option".
7. Dec. '89	Documentation was prepared by officials for an announcement of a decision to privatize through seeking formal proposals from private sector on assumption that private sector would provide coverage in all areas of the country. Announcement was withdrawn the day before it was to be made.
8. Apr. '90	In a memo to regions, the Department stated there were no plans for privatizing the FVIP in the foreseeable future.
9. Jan. '91	Senior officials sought permission to develop a Cabinet Document seeking approval to privatize the FVIP. Cabinet Document was developed but was never sent.
10. Apr. '91	Recommendation to the Minister by departmental officials to discuss with the private sector and determine if many firms were interested in bidding for FVIP's business. Minister accepted it.
11. May '91	Options presented to the new Minister. Minister then decided not to accept the privatization option.
12. Dec. '91	Minister accepted a recommendation to consolidate FVIP.
13. Jan. '92	Minister restated the policy that privatization would be considered if it offered stable and reliable marine insurance at reasonable rates to all fishermen in Canada.
14. Mar. '92	Minister decided on St. John's for headquarters location.
*** NOTE:**	'Privatize' has normally meant the sale of a government business as a going concern and as such the use of the term is misleading as a description of what was intended by the activities described here. What is meant is an attempt to wind up the affairs of FVIP, with the private sector taking over the policies.

remained relatively constant since 1985–86, average indemnities paid per thousand dollars of insurance written have risen sharply in the last three years.

Each of these trends – a rapidly declining insurance base, rising deficits and declining efficiency – would be matters of grave concern to management of any insurance program.

2.150 Each of these trends — a rapidly declining insurance base, rising deficits and declining efficiency — would be matters of grave concern to management of any insurance program, and we would have expected management to have a full understanding of their causes and to have plans to reverse them. However, management has not attempted to determine the causes of these trends. For example, management has no information on whether people leaving the Plan are doing so in order to buy insurance from the private sector, to become self–insured, or to leave the fishery. The Department is satisfied that its volume of business is decreasing, and accordingly no remedial action on this lack of information is planned. No attempts have been made to determine the future impacts of these trends on the Plan.

2.151 The Department responds that its operational philosophy is one of passive competition with other insurers and, accordingly, it would be pleased if it found that fishermen could be persuaded to insure their vessels with commercial insurers instead. However, as noted above, the Department does not know why the numbers have declined and hence cannot act to reverse them.

Our analysis shows that, in the past three years, there has been no improvement in turnaround time.

2.152 The situation of the Plan may become graver as a consequence of the recent moratorium on fishing the northern cod stocks. Although the Minister has announced his intention to assist fishermen with vessels' fixed costs (including gearing up, maintenance, insurance, etc), the Plan will possibly face a significantly increased moral hazard, and may need to develop new insurance policies to provide appropriate coverage for boats laid up as a result of the moratorium or face the loss of a significant portion of its business.

2.153 Service to fishermen. Although the Department does not monitor this, it has agreed that the turnaround time for processing claims is an important aspect of the service provided to FVIP clients. The Plan approves, on average, about 400 claims per year. In 1988 the Department found that one third of its claims took longer than six months to resolve, and concluded then that this was unsatisfactory.

2.154 We observed no action directed at improving this situation, and norms or standards for processing claims have yet to be set. Further, our analysis shows that, in the past three years, there has been no improvement in turnaround time.

2.155 We reviewed in detail those claims that took more than six months to process during 1990–91 and 1991–92. Our analysis showed that nearly half of the turnaround time consisted of delays that could have been avoided if management had a clear understanding of what FVIP's insurance policy covers, proper control and a pro–active approach to claims review. In one case, it took 18 months to pay the claim as headquarters and regional staff could not agree on whether FVIP's policy covered damage caused by lightning (see Exhibit 2.4).

Significant weaknesses in management practices

2.156 Weaknesses in management practices have continued to exist for some time. In combination, these have contributed to the failure to improve client service and possibly to the declining clientele of the program.

2.157 Direction and guidance to regional staff. Following the 1988 action plan, headquarters management made a commitment to develop and implement a claims manual on a priority basis, followed by a comprehensive procedures manual. Further, because it was uncertain about the meaning of key areas of its current policies, it undertook to perform a legal review and to provide the regions with a list of approved policy variations.

2.158 Although a draft claims manual was developed it has not been completed or implemented. No work has been initiated to develop the comprehensive procedures manual. The legal review of current policies has not been completed. In practice, the policies do not appear to have successfully protected the Plan from legal challenge.

2.159 Furthermore, no training on vessel appraising and claims adjustment is provided to staff, and the FVIP Management Committee, composed of headquarters management and the six regional managers, has not met in the last two years. In short, little guidance or direction is provided to staff.

2.160 Although headquarters management has functional authority for the Plan, it has not defined performance targets; nor does it systematically monitor regional activities to ensure consistent quality in the conduct of business. Overall, we found that the Plan is not being run consistently. Among regions, we found considerable variation in the conduct of their activities. One of the consequences is that there is no assurance that the vessels insured with FVIP are not either over–insured or under–insured.

2.161 Review and approval of claims. Headquarters management is responsible for reviewing and approving claims regardless of their size or nature, in an attempt to ensure national uniformity in this area. Since June 1991, the Department has not staffed this function on a permanent full–time basis. On occasion, there has been no one assigned to this task. This has also contributed to delays in settling claims.

2.162 Claims are first reviewed and adjusted by field staff. Each claim is then fully reviewed by the Regional Manager and submitted to headquarters. Headquarters in turn reviews all claims submitted. Because of these levels of review on every claim, most regional managers believe that considerable duplication exists. Often issues arise during the review of claims that result in disagreement between regional and headquarters management. We observed that many of the issues tend to recur. Resolutions of disagreements are not communicated

Exhibit 2.4

CASE 1

- Claim for damages due to lightning.
- Headquarters rejected the claim because "the Plan does not insure against lightning".
- Regional staff identified examples of similar claims approved in the past.
- Legal advice was sought and suggested claim could be paid.
- Legal advice also suggested that policy wording could be changed to prevent future confusion.
- Headquarters maintained decision to reject the claim.
- Fisherman initiated legal action.
- Regional staff again showed examples of similar claims approved in the past.
- Headquarters approved the claim.
- Turnaround time: 18 months.
- Management still not clear as to whether existing policy covers damage caused by lightning.

CASE 2

- Claim for motors that were installed on a new uninsured vessel damaged by fire.
- Motors were originally on an older, insured vessel.
- Considering mitigating circumstances, the regional manager recommended approval of the claim for motors on a "common sense basis".
- Headquarters rejected the claim on the basis that equipment is insured only insofar as it is used on the insured hull.
- Damaged hull was not insured and not claimed.
- Using a broad interpretation of FVIP Regulations, headquarters suggested that the new vessel and motors be retroactively insured so that a claim for both the hull and motors could be paid.
- Regional staff expressed serious reservations about insuring a boat after the fact and requested that the initial claim for motors only be approved.
- Headquarters approved the initial claim for motors.
- Turnaround time: 5 months.

CASE 3

- Claim for latent defect.
- Suggestion that wear and tear may be the cause.
- Special investigation concluded that the cause was latent defect and not wear and tear.
- Regional manager recommended approval of the claim.
- Headquarters argued wear and tear was the cause.
- Headquarters requested the damaged components for examination by metallurgical laboratories.
- Regional manager provided the requested component mentioning that past experience with such examination "has been less than satisfactory".
- No result of metallurgical analysis in the file.
- Headquarters approved the claim.
- Turnaround time: 9 months.

among staff in such a manner as to ensure that similar claims are quickly resolved in the future.

2.163 Furthermore, files sometimes lacked sufficient documentation to support the decisions to pay the claims; as a result, the basis for approving claims was not clear. See Exhibit 2.4 for cases demonstrating these deficiencies.

Solution being considered by the Department

2.164 There are many long–standing deficiencies in need of resolution. While there has been a lack of action directed at specific deficiencies, efforts have been made to implement changes to the structure of the Plan. An announcement was made in April 1992 that the administration of the Plan would be consolidated. The major changes proposed are: FVIP will be headed by a General Manager; the number of regions will be decreased to four; and the headquarters will be located in St. John's, Newfoundland.

2.165 The Department views the appointment of the General Manager as imperative prior to addressing other implementation issues. Two months after the announcement, the appointment of the General Manager had not taken place. The planned changes deal with structure and reporting relationships. At the time of our audit, draft plans did not address how the changes would resolve any of the specific deficiencies observed.

Conclusion

This troubled program has been the subject of considerable study, evaluation and audit, but little action.

2.166 This troubled program has been the subject of considerable study, evaluation and audit, but little action. Deficiencies have been observed, action has been promised and implementation plans drawn up. However, senior management has not demonstrated a sustained commitment to resolving these weaknesses. The last major departmental review of FVIP took place in 1988. The recommendations resulting from that review were not fully implemented and, since that time, the Plan's performance has deteriorated significantly. These performance trends raise serious questions about the Plan's future. The plans provided to us during the audit that dealt with the consolidation and relocation of FVIP's activities are not sufficiently specific to clearly determine whether or when specific deficiencies will be addressed. In mid–August 1992, well after the end of our audit, the Department presented us with an action plan that it claims will respond to all of the deficiencies identified. The Department also claims that this plan will result in the implementation of most of the recommendations made in its 1988 review.

***Department's response:** The Department concurs that there are deficiencies in the management of the Plan and appropriate corrective actions have been identified but, as indicated in the Auditor General's note, their implementation has lagged. However, the Department now has clear direction that the Plan is to remain in the government sector because of its objective which is to ensure that all fishermen, irrespective of their location and type of vessel, have access to vessel insurance at reasonable rates. The focus of our efforts will now be towards improving the management of the Plan and the quality of services to our clients. In this vein, the Department announced that a General Manager of the Plan will be appointed with the responsibility to address those deficiencies identified above.*

Chapter 3

Follow–up of Recommendations in Previous Reports

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Follow–up of Recommendations in Previous Reports

Main Points

3.1 Departments continue to make progress in correcting deficiencies, although it is slow in some areas.

3.2 **Immigration** – Departments involved in these activities have made good progress in implementing some of our recommendations. Improvements have been or are being made in the management of immigration levels, the automation of immigration activities at missions abroad, the control over access to the refugee system, and the initial refugee hearing process, but overall efficiency gains have yet to materialize in the foreign delivery of the Immigration Program. Medical screening procedures have also been reviewed and improvements made at Customs' primary inspection line. More needs to be done, however, in several areas including paper burden, training of personnel, development of efficiency norms and resource allocation abroad, security screening and removals.

3.3 **Department of the Environment – Conservation and Protection** – The Department has made satisfactory progress in many areas within the programs examined in 1991, including the release of its comprehensive environmental strategy, the Green Plan. However, with respect to the implementation of the Canadian Environmental Protection Act (CEPA) and sections 36 to 42 of the Fisheries Act, areas requiring further attention are identification of standards of environmental quality, levels of compliance required to achieve these standards, and assessment of the effectiveness of regulations. The 7 August 1992 ruling of the Superior Court of Quebec on CEPA, and the mandatory parliamentary review of the administration of the Act, might influence future action in these areas. In the Great Lakes, the federal program co–ordination structure has been strengthened, but action to implement changes is slow.

3.4 **Department of National Defence – Human Resource Management** – Progress has been satisfactory on some recommendations. Much remains to be done in several cases. The Department still needs to re–evaluate its Official Languages Program implementation in order to respond to identified needs. Work is still required to ensure that relevant, cost–effective and timely training is provided. The level of medical support required in peacetime to support unique military needs has yet to be defined.

3.5 **Department of the Secretary of State — Education Support** — In the area of Post–Secondary Education Support, progress has been slow. As for the Canada Student Loans Program, the Department is undertaking corrective measures. However, more needs to be done in formalizing and implementing agreements with provinces and in improving the management information system for student loans.

3.6 **Department of Transport — Airports** — While the Department has had some success with runway expansion, it still lacks a clear management strategy and a plan for financing capital needs.

3.7 **Reporting to Parliament** – This issue is addressed in Chapter 6 of this Report. A number of follow–up audits this year have indicated that problems identified previously have not yet been fully resolved.

Introduction

3.8 Departments are taking action to correct deficiencies noted in our Report. Progress is slow in some areas.

3.9 Observations and recommendations made in our annual Report are normally followed up and reported in the Report, two years after the original chapter is published. This year, follow–up has been cancelled on three chapters, and deferred on three others.

3.10 The issues raised in the 1990 chapter on the Crown Corporation Audit Regime were followed up and reported in 1991, Chapter 4, The Accountability Regime – Making it Work. Issues relating to reporting performance will be further reviewed during audits to be completed in the next few years.

3.11 The 1990 chapters on Values, Service and Performance and Efficiency in Government: A Special Study were not audits but studies. Studies are done to increase understanding of important and complex issues, and usually there are no recommendations. Among other things, the insights gained during a study may help us in subsequent audits. Therefore, no formal follow–up is carried out.

3.12 Follow–up on the 1990 Information Security Audit has been deferred until 1994. Departmental internal audit groups are required to conduct an internal audit of compliance with the Government Security Policy in their departments, by the end of 1993. Therefore, we decided that it would be appropriate to defer review of these reports, and of the actions taken by the departments and central agencies to address the deficiencies noted in our 1990 chapter.

3.13 Follow–up on the two 1990 audits of the RCMP — Federal Law Enforcement and Support Services to Canadian Law Enforcement Agencies — has been deferred to 1993.

Elections Canada – 1989, Chapter 10

Background

3.14 Our 1989 chapter on Elections Canada presented observations and recommendations with respect to the electoral process, election support, reporting to Parliament and co–ordination with other electoral offices.

Conclusion

Considerable progress has been made by Elections Canada.

3.15 Considerable progress has been made by Elections Canada in addressing recommendations and observations noted in our 1989 Report.

3.16 We recognize that, given the recommendations of the Royal Commission on Electoral Reform and Party Financing, possible amendments to the Canada Elections Act, and the passing of the Referendum Act, Elections Canada is faced with an evolving environment that has placed heavy demands on its resources. Also, it should be noted that the ultimate test for some of the implemented changes will be an election and/or a referendum; until that happens it may be difficult to assess some areas adequately.

3.17 While Elections Canada has taken some steps to address all of our recommendations, further work is needed in the following areas.

Observations

Planning, Analysis and Documentation

3.18 In 1989 we recommended that Elections Canada adopt a more formal approach to its work and place greater emphasis on planning, analysis and documentation. In our follow–up, we noted that it has established procedures for the preparation of budgets, including those for the costs of holding an election. Also, it has carried out a review of its organizational structure with a view to formalizing the lines of responsibility. As to the documentation of policies and procedures generally, Elections Canada has not yet developed a manual, and many policies and procedures are in draft form. We understand that it plans to formalize them in a manual in the near future.

A strategic plan for its operations has yet to be developed.

3.19 Elections Canada has not yet developed a strategic plan for its operations. However, in 1991 it appointed a Director, Strategic Planning and International Services, with responsibility for developing a strategic plan. In early 1992 a consultant completed a review of the planning process to assist in developing an approach to strategic planning. Elections Canada plans to take action on the consultant's report when resources become available.

Contracting Procedures

3.20 Elections Canada has made improvements to its contracting procedures. Although the Chief Electoral Officer is not subject to government contract regulations, Elections Canada has indicated that it is voluntarily following them where appropriate. However, the contract files are not well organized, and it is difficult to determine whether all the required supporting documentation exists for all contracts. In addition, the draft contracting policy has not yet been formalized. Elections Canada is aware of these problems and is planning to rectify them.

Reporting to Parliament

3.21 In 1989 we recommended that Elections Canada discuss with the Department of National Revenue – Taxation the availability of information on the cost of election tax credits for reporting to Parliament. Elections Canada now reports the cost of such credits in its Part III Estimates. However, the information provided in the 1992–93 Estimates is outdated and incomplete. Elections Canada plans to continue its discussions with National Revenue – Taxation with a view to obtaining more complete and up-to-date information.

The Departments of National Revenue – Taxation and Finance – Charities, Non-Profit Organizations and the Income Tax Act – 1990, Chapter 10

Background

3.22 Our 1990 chapter on Charities, Non-Profit Organizations and the Income Tax Act presented observations and recommendations on the administration of the Income Tax Act with respect to charities and non-profit organizations.

Conclusion

3.23 The departments of Finance and National Revenue – Taxation are addressing some of our concerns. However, we are still concerned that there may be no effective penalty for non-compliance. We are also concerned that it is still possible for charities to circumvent the intent of the Income Tax Act pertaining to allowable business activities and that certain legislative rules pertaining to non-profit organizations need to be clarified.

Scope

3.24 As a follow-up we reviewed a status report prepared by the Department of National Revenue – Taxation explaining the action it has taken on our observations and recommendations. We also conducted interviews and reviewed related documentation.

Observations

Charitable Organizations

Late filing

3.25 Our 1990 audit concluded that not levying the mandatory late–filing penalty, delaying revocation of registration for failure to file annual returns, not instituting legal proceedings to enforce the filing requirement, and reinstating revoked registrations acted as disincentives for charities to meet the legislative requirement for filing.

3.26 Our follow–up found that, after consultations with charities, the Department of National Revenue – Taxation "concluded that a late–filing penalty was not as effective as revoking registration" and that "the penalty would only serve to further reduce the already scant resources available to a charity's beneficiaries." The Department also believes that "voluntarism should not be discouraged through undue threat of penalties for non–compliance." It is therefore studying proposals to amend the Income Tax Act to exclude registered charities from the late–filing penalty imposed under section 162(7).

3.27 The Department is now revoking the registration of charities that do not comply with the filing requirement. The initiation of revocation proceedings imposes costs on a charity and is not necessarily less costly than a late–filing penalty. The costs could include administrative costs, accounting costs and professional fees. It is also important to remember that revocation of a charity's registration may result in the imposition of a revocation tax due within one year of the effective date of revocation. This penalty tax is equal in amount to the assets that the charity has not disbursed to qualified recipients.

Revocation of charitable status

3.28 Our review of files in 1990 found no evidence of any follow–up to determine whether revocation tax was due from charities whose registrations had been revoked for failure to file, or from those requesting revocation of their status. Our follow–up found that the Department is addressing our concerns.

Penalties for non–compliance

3.29 Our 1990 audit noted that when a registered charity contravened the provisions of the Income Tax Act — apart from not filing and committing fraud — the only sanction available to the Department of National Revenue – Taxation was to exercise its right to revoke registration. The legislation does not provide the Department with the power to levy a monetary penalty or to tax unrelated business profits earned by the charity.

3.30 Our follow–up found that, starting in January 1993, almost all information provided with the Public Information Return will be available to the public on request. The Department of National Revenue – Taxation believes this measure should prove a very potent incentive for charities to comply with the requirements of the Income Tax Act, because the donating public would have access to material previously considered confidential. The Department is also placing more emphasis on educating the charity sector about the requirements of the Income Tax Act.

3.31 The Department's position with respect to sanctions is as follows:

> "The Department agrees that some form of sanction is required to ensure that charities honour their obligations under the Income Tax Act; however the nature of these sanctions must necessarily differ because of the particular nature of the charities sector and the peculiarities of their problems. For example, the funds are given to

these organizations, largely made up of volunteers, for charitable purposes only.

Bearing in mind the intent of the tax incentive, any such sanctions should ensure that the charitable objectives do not suffer unduly because of any negligence or wrongdoing on the part of those administering the charity.

To enforce current sanctions, the Department will:

- more strictly adhere to the annual revocation cycle;
- increase the number of restricted audits;
- do random follow-up audits of revoked charities; and
- ensure revoked charities appropriately distribute their assets and/or pay their revocation tax."

3.32 We support these initiatives. However, they do not adequately deal with our concern that there may be no effective penalty for non-compliance. If a charity contravenes the Income Tax Act, its registration may be revoked, and, as previously stated, revocation may result in the imposition of a penalty tax. To avoid this penalty and preserve their assets, the principals of a charity can incorporate a new charity, which the Department must register if it satisfies the requirements of the Act. The assets of the old charity can be transferred to the new charity. Given this legislative framework, if a charity contravenes the Act by, for example, carrying on an unrelated business, the new charity that it creates may end up keeping any profits earned. Thus it would profit from non-compliance. This is a disincentive for a charity to comply with the Act and it could be unfair to a competing private sector business.

Donation receipts

3.33 Our 1990 audit found that although the Department of National Revenue – Taxation did examine donation receipts, it did not have an appropriate audit program to determine their validity.

3.34 The Department is now addressing our concerns. It has advised us that a mainframe program, in the final stages of design, will assist in the comprehensive monitoring of charities. This program will provide the technology to match taxpayer receipts and to identify non-complying charities for post-assessment.

3.35 In 1990 we reported that it was possible for charities to circumvent the intent of the Income Tax Act pertaining to allowable business activities.

3.36 In our follow-up we found that the Department of National Revenue – Taxation, after consulting with the charity sector, will use an interpretation of "related business" based on the tests set out by the Federal Court of Appeal in the case of Alberta Institute on Mental Retardation v. The Queen. The Department's position will be explained in greater detail in a December 1992 publication devoted exclusively to business activities. Because the law has not been amended we are still concerned that charities will be able to circumvent the intent of the Income Tax Act pertaining to allowable business activities.

Information to the public

3.37 We found in 1990 that relevant, accurate and complete information was not always available to the public through the Public Information Return.

3.38 The Department is now addressing our concerns. Among other things, a revised information return has been prepared, standards for financial statements will be developed, and the public will be advised that the Department does not assume responsibility for the accuracy or completeness of the Public Information Return.

Information on non–compliance

3.39 We reported in 1990 that the Department of National Revenue – Taxation did not have a program to analyze examination data and provide the information necessary for management to evaluate the extent of voluntary compliance with the law.

3.40 The Department is now revising the annual information return to assist its audit activities. We support this initiative. We believe that it is important not only to identify non–complying charities but also to try to find out why they did not comply. We were informed that the Department has undertaken some projects to monitor the reasons for non–compliance.

Non–Profit Organizations

Filing Requirements

3.41 In 1990 we expressed concern that because there were no annual filing requirements for all non–profit organizations, the Department of National Revenue – Taxation had not developed a compliance program to secure an effective check on the right of such organizations to enjoy exemption from taxation.

3.42 Consultations between the departments of Finance and National Revenue – Taxation have been ongoing since then. A detailed ways and means motion to amend the Income Tax Act was tabled in Parliament on 19 June 1992, requiring non–profit organizations to file annual returns for fiscal years ending in 1993 and thereafter.

Commercial activities

3.43 Our 1990 audit also found that certain legislative rules needed to be clarified. We commented on the fact that in a 1983 decision (The Gull Bay Development Corporation v. The Queen), the Federal Court – Trial Division held that if profit from a commercial activity is used to fund social and welfare objectives, the organization is not operating for a profit. This may enable a non–profit organization to carry on any type of commercial activity. We also pointed out that there are circumstances that enable members to benefit from an organization's tax–exempt status.

3.44 In the course of our follow–up the Department advised us that it considers "that the case confirms that a non–profit organization may conduct a commercial operation where the activity itself is the means of carrying out the non–profit organization's objectives". In its view, "this does not sanction the conducting of a commercial activity that has nothing to do with carrying out the non–profit organization's objectives other than supplying profits to achieve those objectives". National Revenue–Taxation has advised us that the information received on the new annual returns for non–profit organizations will be used to determine the significance, if any, of the incidence of non–profit organizations conducting commercial activities that have nothing to do with carrying out the non–profit organizations' objectives.

3.45 We are still concerned that certain legislative rules need to be clarified. We are unable to provide Parliament with reasonable assurance that the law is sufficiently clear to see that only organizations "organized and operated exclusively for social welfare, civic improvement, pleasure and recreation or for any other purpose except profit" are entitled to exemption from tax as non–profit organizations.

Co-ordination of the Immigration Program has been improved.

Immigration — Management of the Immigration Program — 1990, Chapter 12

Background

3.46 In 1990 we reported on four major areas of the Immigration Program: the overall management of the Program, the delivery of immigration activities abroad, the processing of refugee claims in Canada, and control and enforcement activities. Each of these topics formed the subject of a separate chapter in our report to Parliament. The same approach has been used to report on our follow-up.

3.47 Two significant events have occurred since our last audit. First, Employment and Immigration Canada (EIC) focussed considerable effort on reviewing several key Program management and control mechanisms, and the Minister of Employment and Immigration recently proposed a series of important amendments to the Immigration Act. Bill C-86 was tabled in the House of Commons in June 1992 and was subsequently referred to a legislative committee for study. According to EIC, the primary aims of the proposed amendments are to improve the management of the immigrant selection system, preserve the integrity of the Program, better protect Canadian society, and make the refugee status determination process simpler, fairer and more efficient. We found that the text of Bill C-86 addresses many of the observations and recommendations made in our 1990 Report.

Reasonable progress has been made in the overall management of the Immigration Program.

3.48 The other event, in August 1992, was the transfer of responsibilities for foreign delivery of the Immigration Program from External Affairs and International Trade Canada to Employment and Immigration Canada (EIC). This transfer should clarify the accountability of stakeholders and improve the co-ordination of Program activities as a whole. EIC and the Department of National Health and Welfare (NHW) were also discussing the transfer of NHW's Division of Immigration Overseas Health Services to EIC.

Conclusion

3.49 In addition to the above-mentioned elements, EIC has made reasonable progress in response to several of our observations and recommendations concerning the overall management of the Immigration Program. For instance, Program co-ordination infrastructure has been improved and steps have been taken to better manage immigration levels. EIC has also made reasonable progress in the areas of cost recovery and Program evaluation.

3.50 On the other hand, given the importance of training to the delivery of the Program, we feel that EIC management should pay more attention to this question. We have also noted that the quality of information to Parliament still needs to be improved.

Areas of Reasonable Progress

3.51 **Co-ordination of the Immigration Program.** There have been significant improvements in the Program's co-ordinating infrastructure. Following a Treasury Board directive, an interdepartmental committee on resources allocated to immigration was formed, comprising representatives of 12 departments and agencies involved in the Program. The main purpose of this committee is to facilitate the preparation of quarterly reports to Treasury Board on levels of immigration, overall Program expenditures and revenue from cost recovery. A co-ordinating committee at the assistant deputy minister level has also been set up to handle issues of policy and overall Program orientation. EIC has also set up committees responsible for liaison with other departments.

3.52 Following the transfer of responsibilities for immigration operations abroad, EIC and External Affairs signed an agreement that sets out a new division of responsibilities and resources. EIC and the Department of National Health and Welfare (NHW) were also discussing the transfer of NHW's Division of Immigration Overseas Health Services to EIC. However, few changes have been made to the other interdepartmental agreements that existed in 1990.

3.53 Management of immigration levels. In 1990 we reported that planned immigration levels had been significantly exceeded for the previous three years. In October 1990, EIC announced annual immigration levels based on a five–year plan and replaced "range" levels with specific levels for each class of immigrants. Instructions were given to External Affairs to improve management of the number of immigrants selected abroad. In 1991 the total number of immigrants was six percent less than the overall planned level. Since August 1992, EIC has been responsible for processing immigrant applications abroad.

3.54 Bill C–86 provides for a new immigration level management system that would group immigrant classes into three streams, only two of which would be subject to annual fixed limits.

3.55 Immigration cost recovery. EIC reacted positively to our recommendation that it clarify the basis for setting fees and that it periodically review the costs of providing immigration services and the related fees. EIC has adopted a basic policy of recovering as much of the cost as possible, taking into account the fees charged in other countries. A plan was developed to raise fees over a period of three years. EIC is also looking into the possibility of charging fees for a number of other services that currently are being provided free of charge.

3.56 Program evaluation. In 1990 we found that a number of key Program components had not been evaluated. EIC has since prepared a plan for evaluating the entire Program over a period of seven years. For example, a pre–evaluation assessment of the settlement component has been carried out. An evaluation of the primary inspection line at ports of entry has been completed in co–operation with National Revenue–Customs and Excise. EIC was also carrying out a pre–evaluation assessment of activities abroad.

Areas of Slow Progress

3.57 Training of personnel with immigration responsibilities. In 1990 we found that some personnel with immigration responsibilities were not adequately trained and that responsibilities for training were not clear.

Personnel training has been improved but more needs to be done.

3.58 Although improvements have been made in EIC's internal operational training program, more needs to be done to ensure that all personnel with immigration responsibilities possess the knowledge and skills necessary to discharge their duties. EIC still has no system for needs identification, recording of training received and validation of training. It is therefore unable to monitor its own training activities. No new monitoring mechanism has been established with respect to operational training by other stakeholders.

3.59 Information to Parliament. We noted in our 1990 Report that information to Parliament on the Immigration Program was incomplete and fragmented. Since then, EIC has restructured its Estimates Part III. Budgeted Immigration Program costs are now grouped and disclosed under one heading. The various program activities are listed, as well as the related costs. Reference is also made to the other departments and agencies involved in Program operations. But EIC's Part III still does not set out standards for assessing the performance of specific operations.

3.60 Information on immigration activities and costs of other stakeholders in the Program are either disclosed separately in their Estimates (Part III) or are buried among their other activities. Consequently, the information provided to Parliament is still fragmented.

Immigration — Foreign Delivery — 1990, Chapter 13

Background

3.61 In 1990 we reported on the delivery of the Immigration Program outside Canada by the Department of External Affairs. The Department's role involved processing immigrant and visitor visa applications, including a growing enforcement and control activity designed to prevent illegal entry into Canada.

There has been good progress on some of our recommendations but overall efficiency gains have yet to materialize.

3.62 Responsibility for the delivery of the Immigration Program abroad was transferred to Employment and Immigration Canada (EIC) in August 1992. A Memorandum of Understanding between EIC and External Affairs specifies in more detail the responsibilities of each department and the resources to be transferred.

Conclusion

3.63 The Department of External Affairs has made good progress in implementing some of our recommendations. The benefits in terms of improved overall efficiency have yet to materialize. Improvements have been made in the management of target levels, automation of immigration activities at missions, and use of locally engaged program officers. The Department is developing mission-specific efficiency norms and enhancing the role of internal audit. There has been little progress in streamlining the processing procedures aimed at reducing the paper burden in the system.

3.64 Our 1990 chapter indicated a concern with the imbalance in the allocation of resources in various regions of the world. The Department had taken a decision to start reallocating resources based on changes in workload for each of the missions. However, implementation plans were delayed when the government announced the transfer of the Department's responsibilities for the foreign delivery of the Immigration Program to EIC. EIC informed us that it intends to carry out these plans.

Areas of Reasonable Progress

3.65 **Management of target levels.** We recommended in 1990 that the Department put measures in place to meet EIC's requirements for a predetermined number of landings and to overcome the missions' wide deviations from assigned targets. Our recommendations included: taking into account relative demand in setting targets; formally involving Heads of Missions in the target-setting process; and adjusting mission targets during the year.

3.66 The Department has put measures in place to achieve these objectives. Mission targets were developed that took into account a number of factors including the relative volume of cases processed the previous year at each mission as well as the relative backlogs at each mission. A database was created to allow mission targets to be established on a component basis. The Department informs us that Heads of Missions are now increasingly involved in setting targets. Throughout 1991, performance was closely monitored and adjustments were made to individual mission targets. The successful implementation of these measures is reflected in the fact that deviations from the 1990 and 1991 global targets were respectively 5 percent and 3 percent compared to a deviation of 33 percent in 1989.

3.67 **Automation.** The Department responded positively to our recommendation that there be a worldwide acceleration in the automation of immigration activities, particularly at high–volume missions. Between April 1990 and the end of March 1992, the Department installed the Computer Assisted Immigration Processing System (CAIPS) in Paris, Manila and all missions in the United States. Prior to 1990, it had installed the system in Hong Kong and London. In addition to the foregoing the Department has installed automation equipment at 31 missions not scheduled for early CAIPS installation.

3.68 **Locally engaged program officers.** We recommended that the Department should convert more Canada–based officer positions to locally engaged program staff positions. The Department responded by increasing the proportion of locally engaged program staff.

3.69 **Internal audit.** In 1990 we recommended that the Department's Internal Audit Division be requested to provide an audit conclusion to both the departmental Audit and Evaluation Committee and the Canada Employment and Immigration Commission on the degree of compliance with the Immigration Act and Regulations and its related policies and procedures. This has been done. In our report we also recommended that the Committee should direct Internal Audit to provide an audit conclusion on the system for measuring and reporting on the efficiency of immigration operations, on both a mission and a global basis. Although the Department is receptive to this suggestion, no action can be taken until the mission–specific efficiency norms that are now under development have been completed. Internal Audit is committed to implementing this recommendation once the efficiency norms are in place.

3.70 **Medical screening procedures.** In our 1990 Report we observed that medical screening procedures were inefficient and management controls weak. We recommended that the Department, in consultation with EIC and the Department of National Health and Welfare, introduce risk–based sampling procedures that reduce the amount of checking done by Canadian–based medical officers and develop a better system for monitoring the performance of designated medical practitioners.

3.71 An interdepartmental committee, chaired by EIC, conducted a Medical Inadmissibility Review and concluded that risk–based sampling procedures were not an acceptable option because inadmissible persons could be admitted to Canada. However, EIC indicated that this issue needs once again to be further examined before a final decision can be made. The Department of Health and Welfare has also revised and documented its guidelines for selecting, training and assessing the performance of designated medical practitioners. Their performance was reviewed at some European missions.

Areas of Slow Progress

3.72 **Efficiency norms and resource allocation.** In 1990 we

The management of mission targets was improved.

At New Delhi, a high–volume mission, the registry has been fully automated in advance of CAIPS installation (see paragraph 3.67).

recommended that External Affairs develop mission-specific efficiency norms for both the length of time and the amount of resources necessary to process visa applications abroad, to use in better allocating departmental resources and adjusting staff levels. Although no mission-specific efficiency norms have been set, the Department has established global "length of time" norms covering that aspect of immigrant processing work, up to and including the paper screening of the application. In addition, global norms have been set for the elapsed time between the finalization of a case and the typing and issuance of immigrant visas. The Department has developed a database that links EIC data on processing abroad and landings in Canada, in order to establish norms for the other aspects of the immigrant processing work.

3.73 The Department has contracted with Consulting and Audit Canada to develop a resource allocation model, by developing and quantifying the work units for immigration and visitor visa services and by developing and applying workload standards for these units of work. Input data was collected during field visits conducted in April 1992. The usefulness of this exercise will depend on how the norms are used to improve the level of service and utilization of resources.

The imbalance in the allocation of staff around the world is still a concern.

3.74 Our 1990 chapter indicated a concern with the imbalance in the allocation of resources to various regions of the world. External Affairs had taken a decision to start reallocating resources based on changes in workload for each of the missions. However, implementation plans were delayed by the transfer of External Affairs' responsibilities for the foreign delivery of the Immigration Program to EIC. EIC informed us that it intends to carry out these plans.

3.75 **Streamlining procedures.** The 1990 audit observed an excessive paper burden and recommended that the Department, in consultation with EIC, examine ways to streamline procedures and to simplify the use of immigration forms and documents at missions abroad. The Department has developed, also in consultation with EIC, plans to streamline procedures supporting the delivery of the Immigration Program abroad. The implementation of this recommendation should be facilitated by the recent reorganization whereby EIC will have responsibility for both immigration policy and foreign delivery of the program. No tangible results in the form of reduced paper burden can be shown yet. However, EIC is confident enough to introduce, in December 1992, a generic visa that will replace numerous documents now in use. Moreover, External Affairs has recently hired a consulting firm to develop a "quality of service" implementation plan, that will, upon completion in late 1992, train managers to identify inefficiencies and correct them. Further, an action plan has been developed by the Department to evaluate procedures, techniques and materials used in program delivery, with a view to identifying inefficiencies and then developing procedural and management models to correct them. Plans are also under way to improve on the issuance of student authorizations, to revise and reformat the Immigration Manual and to review the Pre-application Questionnaire.

3.76 **Waiving of interviews.** Our 1990 Report recommended that the Department assess the risks of fraud at each mission and issue guidelines to assist mission staff in determining the most appropriate balance between waiver practices and degree of risk at that mission. The Department has replied that the recommendation is being addressed within the context of a project that will examine all aspects of visa office performance. This project is in the very early stages of development, and it is unlikely that guidelines will be developed before the end of 1992.

Immigration — Refugees — 1990, Chapter 14

Background

3.77 Our 1990 chapter contained observations and recommendations aimed primarily at increasing the efficiency of the new refugee status determination system that came into force 1 January 1989 under the Immigration Act. We also examined the backlog clearance program set up for the 85,000 cases that were still unprocessed as of 31 December 1988.

3.78 As mentioned in paragraph 3.47, the Minister of Employment and Immigration recently tabled a series of amendments to the Immigration Act. Some of these amendments deal with the refugee status determination system. The intent of the proposed amendments is primarily to reserve access to the system to those who are truly in need, to streamline the system to encourage expeditious and cost-efficient decision making, and to ensure that decisions are acted on promptly. The proposed amendments address many of the observations and recommendations that we made in 1990.

Conclusion

3.79 Employment and Immigration Canada and the Immigration and Refugee Board (IRB) have made reasonable progress toward correcting some of the deficiencies that we noted in 1990. Improvements have been or are being made in several areas: control over access to the system, streamlining of the initial hearing process, scheduling of hearings and control over interpreters.

3.80 Progress has been slower in other areas. The number of hearing adjournments is still high, for example. More needs to be done in personnel training. In general, refugee claimants still do not undergo medical examinations and security checks until they request permanent residence. Regarding the backlog of claims, EIC does not expect to complete this process before March 1993.

Areas of Reasonable Progress

3.81 **Safe return.** In 1990, we noted that the safe return provision in the Immigration Act had never been put into practice. It was one of the reasons why the number of claims processed in Canada was far greater than the volume projected when this legislation was being prepared.

3.82 Employment and Immigration Canada recognizes that international co–operation is needed to manage and resolve the refugee issue. Bill C–86 therefore replaces the concept of a "safe third country" with a series of measures for sharing responsibilities in determining refugee status, including bilateral agreements with certain countries signatory to the Geneva Convention on Refugees. These agreements would make it possible to process claims for refugee status in the first country where the claimant found asylum. EIC, in co–operation with External Affairs, is currently discussing such agreements with other countries.

The refugee status determination process has kept pace with new claims.

3.83 **Streamlining the initial hearing process.** In 1990 official hearings were held even in cases where the representative of the Minister of Employment and Immigration felt that claimants had a credible basis for making a refugee claim. Following a pilot study, EIC adopted a simplified inquiry process, which eliminates official hearings for claims that are not challenged by the Minister's representative. Bill C–86 would simplify the refugee status determination system even further by eliminating the initial hearing completely.

3.84 **Scheduling of hearings.** As of 31 March 1990, the refugee status determination system had encountered significant delays and 23,500 claims were pending at various stages of the process. Since then, the process has incurred no further delays and has kept pace with new claims. This is due not only to the improvements in the scheduling of hearings but also to the increase in resources allocated to the system, and to other steps taken by EIC and the Immigration and Refugee Board. However, as mentioned in paragraph 3.88, little progress has been made with regard to adjournments. The number of cases pending as of 31 March 1992 represented about three months of work for EIC and the Immigration and Refugee Board.

The number of hearing adjournments is still high.

3.85 Interpreters. In our initial audit, we recommended that EIC and the Immigration and Refugee Board ensure that interpreters are qualified, have proper security clearance, and are not in a conflict–of–interest situation. EIC and the Immigration and Refugee Board have since developed an accreditation program that includes testing to determine the competence of interpreters by ensuring that they meet a prerequisite language standard. The test was first administered to a group of interpreters in 1991.

3.86 Security checks are now required for all interpreters. All interpreters are also required to sign a declaration of any possible conflicts of interest. At present, security checks have been completed for about half of the interpreters who have passed the accreditation test.

3.87 Because the pool of interpreters is limited, EIC and the Immigration and Refugee Board continue to use existing interpreters whose test results and security clearance remain pending.

A great deal of work remains to be done to finalize all backlog cases.

Areas of Slow Progress

3.88 Adjournments. In 1990 we found that 33 percent of initial hearings and 27 percent of second hearings were adjourned. Each adjournment delayed the process by one month. Despite efforts by EIC and the IRB to decrease adjournments, the situation has not improved. In 1992, 40 percent of first hearings and 29 percent of second hearings were adjourned. As in 1990, adjournments are due mainly to legal counsel not being ready to proceed and to the fact that there is insufficient time scheduled for completion of hearings. The average amount of time required to process a claim at both hearings is now 8.5 months, compared to 9 months in 1990.

3.89 Training. In 1990 we noted that the training given to Case Presenting Officers (CPOs) was inadequate. Since our audit, all but a few of the new CPOs in main offices across the country have taken the national basic training course. To meet important training needs of experienced CPOs, EIC developed an advanced course which was offered on a pilot basis in March 1992. In light of the anticipated changes to the Immigration Act, further offerings of this course have been postponed.

3.90 Medical examinations and security checks of claimants. In 1990 we recommended that medical examinations and security and criminality checks be conducted promptly following the receipt of claims for refugee status. No progress has been made in this area since our audit. In general, claimants still do not undergo medical examinations and security checks until they apply for permanent residence, several months after their arrival in Canada.

3.91 An interdepartmental committee on the medical inadmissibility of immigrants has recommended that claimants, when making their claims, each be given medical instructions and that a system be set up to ensure that claimants undergo medical examinations within 60 days of receiving these instructions. These recommendations are included in the proposed amendments to the Act tabled in the House of Commons in June 1992.

3.92 Investigations. Our 1990 audit revealed that EIC had not taken any steps to trace backlog claimants who had failed to respond to a notification to appear. Since then, EIC has made efforts to increase the number of investigations, but further improvement is needed. Between the start of the backlog clearance program and 31 March 1992, 32,900 people have failed to respond to a notification to appear. During this same period, 20,500 investigations were conducted and people were located in half of these cases.

3.93 **Backlog clearance.** In 1990 we expressed doubts about the capacity of the system to eliminate the backlog within the budgetary limits and by the deadline of 30 September 1991 set by EIC. By 31 March 1992 the backlog of cases had not been eliminated; EIC announced that the remaining claims would be processed in full by 31 March 1993.

3.94 Since our audit, 10,000 new cases have been added to the backlog. This has increased the workload and altered the initial schedule, which was based on a total of 85,000 cases. All the Backlog Canada Immigration Centres have been closed, with the exception of those in Toronto and Mississauga, and cases not finalized have been transferred to regular Canada Immigration Centres.

3.95 As of 31 March 1992, there were 41,600 cases that remained to be finalized, the majority of them in Ontario. About 19,000 of these cases were awaiting a decision; another 9,000 were awaiting landing, which is the last stage in the process. Thus, a great deal of work remains to be done to finalize all backlog cases.

3.96 As to costs, EIC and the Immigration and Refugee Board had spent, as of 31 March 1992, a total of $114 million to process backlog cases. Another $5 million had been used for language training and settlement assistance. EIC and the IRB expect to process the entire backlog of cases within the approved budget of $181 million.

Immigration — Control and Enforcement — 1990, Chapter 15

Background

3.97 The Canadian immigration control and enforcement system is structured around three main intervention points: overseas screening, port of entry examinations and inland control and enforcement. In 1990 we raised concerns about the operational effectiveness of some key control and enforcement activities.

3.98 As mentioned in paragraph 3.47, the Minister of Employment and Immigration recently proposed, through Bill C-86, a series of amendments to the Immigration Act. Some of these proposals impact on control and enforcement activities at all three intervention points. The intent of the proposed amendments is to better protect Canadian society from those who break our laws and to curtail abuse of our immigration system. They address many of the observations and recommendations that we made in 1990.

Conclusion

3.99 The various departments involved in enforcement and control activities have made good progress in implementing some of our recommendations. For instance, medical screening procedures are being streamlined and improvements made at Customs primary inspection line. Immigrant entrepreneurs are now subject to better controls and measures have been taken to increase the efficiency and effectiveness of investigators. Employment and Immigration Canada (EIC) is also in the process of streamlining the use of Minister's permits.

3.100 In other areas, progress has been slow. Decisions about whether to admit immigrant applicants who have been the subject of security concerns by the Canadian Security Intelligence

Service after 1990, are still pending in most cases. Although measures taken by EIC have resulted in an overall increase in the number of removals, we found that, as in 1990, either the carrying out of removal orders affecting refugee claimants is delayed or their effect is cancelled in a majority of cases.

Areas of Reasonable Progress

Primary Inspection Line (PIL)

Medical screening procedures have been reviewed.

3.101 Lookout information. In 1990 we noted the lack of appropriate immigration lookout information and deficiencies in the format and use of the existing information. Since our audit, an automated system has been integrated with the Customs system and installed in major airports, making possible a more systematic check on whether travellers seeking to enter Canada are the subject of immigration lookout notices.

3.102 We noted little progress, however, in the management of lookout information at land border points. EIC has attempted, without real success, to set up provisional mechanisms for improving the management of lookout notices. Customs is presently testing an electronic licence plate reading device that could eventually help to remedy the situation.

Management of lookout information at major airports has been improved.

3.103 PIL performance measurement and feedback. In 1990 there was no performance measurement system for immigration–related work, and feedback information on referrals was limited. Since then, EIC, in consultation with Customs, conducted the first–ever comprehensive evaluation of PIL effectiveness from the standpoint of immigration. A final report had not been issued at the time of our follow–up. The two departments have yet to define what constitutes regular and meaningful feedback on cases referred to EIC by Customs.

3.104 Training of customs officers. In 1990 we noted that training of customs officers on immigration matters was limited and inconsistent. Since then, Customs has taken steps at the local level to update the knowledge of experienced customs officers and to provide basic training to many students recruited as customs officers. However, minimum standards regarding content, documentation, presentation and duration have not yet been applied to all of this training developed at ports of entry. The sessions are still not evaluated or validated.

Medical Screening

3.105 The Immigration Act specifies two medical criteria for denying prospective immigrants and visitors entry to Canada: "danger to public health or safety" and "excessive demands on health and social services". We noted in 1990 that some medical procedures to identify danger to public health or safety were inconsistent, and that the determination of what constitutes excessive demand was very subjective.

3.106 As indicated in their responses to our Report in 1990, EIC and the Department of National Health and Welfare (NHW) tasked a special Medical Inadmissibility Review Committee with reviewing all medical conditions and related issues to ensure that the current medical guidelines for inadmissibility are appropriate, just, and compatible with current medical opinion. The issue of danger to public health was examined and the Committee recommended that current mandatory testing for VDRL (syphilis) be removed to ensure consistency in the application of medical inadmissibility criteria. The Committee also examined the criterion of excessive demand and reported that there was a need to define what constitutes excessive demand with reference to the availability, accessibility and cost of health and social services required.

3.107 EIC, in conjunction with National Health and Welfare, recently approved those recommendations of the Committee. The government has also proposed an amendment to the Immigration Act that would, by regulations, better define excessive demand. However, the departments acknowledge that it will take time to compile information on available services, the demand on those services and their costs across Canada, before the regulations can be implemented.

Entrepreneurs

3.108 Our follow–up review found that substantial progress had been achieved in the management of the entrepreneur program. EIC has modified its procedures to include a provision for imposing conditions on all entrepreneurs and has put in place a computer–based monitoring system. EIC also initiated inquiry proceedings for some entrepreneurs it considered did not comply with conditions.

Investigations

3.109 Since 1990, EIC has increased the resources allotted to investigations and related enforcement activities. The efficiency of investigators has been improved by providing them with direct access to the Canadian Police Information Centre files, through the use of terminals in several of the major immigration centres. The quality of information available to investigators and managers has also been improved.

The efficiency of investigators has been improved.

3.110 Bill C–86 would authorize the use of fingerprints and photographs to secure positive identification of refugee claimants. EIC is also evaluating new technology designed to reduce the use of fraudulent documents to gain entry into Canada.

3.111 The workload of investigations in one region that we noted was high in 1990 remains substantial. However, a detailed analysis done by EIC has shown that the actual number of cases involving serious criminality, which could result in removals, is relatively low and these cases are given high priority by EIC.

Minister's Permits

3.112 We observed in 1990 that pro–forma activities (carried out for the sake of form) had a serious impact on efficiency. In Bill C–86, the government proposes measures that would reduce the incidence of such activities associated with minor infractions by visitors and foreign students. However, pro forma activities related to removal orders have not been eliminated. EIC has expressed a concern that any mechanism to override or dispense with a removal order without the individual leaving Canada might undermine the enforcement process. We still believe that the process used is inefficient and should be given further study.

3.113 In 1990 we recommended that EIC take steps to monitor and analyze the use of Minister's permits. The Minister's 1991 report to Parliament on this matter reflects a change toward the recommended direction.

Areas of Slow Progress

Security Screening

3.114 **Admission to Canada.** In 1990 we noted that only a small percentage of immigrant applicants, who were the subject of security concerns by the Canadian Security Intelligence Service (CSIS), were denied admission to Canada. We also reported that the majority of security cases awaiting decisions by EIC involved people who were already living in Canada. Furthermore, criminal checks were incomplete.

3.115 Since our audit, EIC has reached decisions on most of the cases pending in 1990. In the vast majority of cases, the applicant was accepted as a landed immigrant. We noted, however, that decisions for most of the briefs issued after 1990 were still pending, especially where they involved persons already living in Canada. On the other hand, CSIS states that often the information available is not sufficient to support a denial of admission to Canada, although there are national security concerns. In most cases, foreign agencies do not provide criminal intelligence (as opposed to criminal record information) and therefore criminal checks continue to be incomplete. The situation consequently remains similar to what we reported in 1990.

Decisions for most of the briefs issued by CSIS after 1990 regarding immigrant applicants were still pending.

3.116 Effectiveness of screening activities. We recommended in 1990 that EIC evaluate, in collaboration with CSIS and External Affairs, the effectiveness of their security screening activities. EIC has yet to do so following the approval and implementation of amendments to the Immigration Act regarding inadmissibility criteria relating to security and criminality.

3.117 A pilot project on security screening activities abroad, which was just starting at four posts at the time of our 1990 audit, has since been expanded to include all posts. An evaluation of this pilot project is planned for 1992–93, which should be an important element of a future effectiveness evaluation.

Obligations of Transportation Companies

3.118 Since 1990, negotiations between Justice and transportation companies have resulted in the collection of some $3.2 million for amounts assessed prior to 1 January 1989. An amount of $2.2 million was written off. However, collection of fines and detention costs imposed since that date remains problematic. Many companies continue to systematically contest all fines and detention costs. Bill C–86 would introduce administrative means of recovering costs associated with infractions by transportation companies. This approach would replace, for the most part, the use of fines to promote compliance with the Act.

Carrying out of removal orders affecting refugee claimants is delayed or their effect is cancelled in a majority of cases.

Removals

3.119 Our follow–up has shown that the measures taken by EIC have increased the overall number of removals. As in 1990, however, the carrying out of removal orders affecting refugee claimants is delayed or their effect is cancelled in a majority of cases. EIC has noted that as the number of removal orders has increased, the proportion of individuals who hide when due to report for removal has grown substantially. The cost of locating these individuals is significant, and EIC has stated that budgetary considerations limit the number of removals.

Field Operations Support System

3.120 Our 1990 audit found that access to the Immigration Field Operations Support System (FOSS) and the quality of data it contained needed to be improved. Our follow–up has shown that the situation has not improved significantly. The last two years have seen continued reliance by immigration enforcement operations on locally developed systems to generate required management and operational data. EIC is undertaking certain initiatives to improve the situation.

Consumer and Corporate Affairs — 1990, Chapter 16

Background

3.121 In 1990 we reported on the implementation and administration of six major Acts by the Department of Consumer and Corporate Affairs (CCA). They were the Bankruptcy Act, the Canada Business Corporations Act, the Patent Act, the Competition Act, the Weights and Measures Act, and the Electricity and Gas Inspection Act. We also reported on the administration of the Trade–marks Act which, along with the Patent Act, is the responsibility of CCA's Intellectual Property Directorate (IPD). Our follow-up reviewed the action taken by the Department to address our 1990 observations and recommendations.

Conclusions

3.122 We found that the Department has addressed most of the recommendations that we made in 1990. However, our concerns in the Intellectual Property Directorate (specifically the Patent Office and the Trade-marks Office) and in the Corporations Directorate have not been resolved. The Department believes that the initiatives that are under way will allow it to respond to these concerns. Finally, some action has been taken on our recommendation in the Marketing Practices Branch, but progress has been slower than expected.

Observations

Intellectual Property Directorate

3.123 The Patent Office is part of the Intellectual Property Directorate (IPD). It is responsible for granting patents and disseminating information related to patents. In 1990 we found that service levels in the Patent Office had declined substantially over the preceding five years and were unlikely to improve. We also found that there was a lack of a quality assurance component in the patent examination process. We recommended that the Patent Office review its forecast of future workloads, develop a strategy for meeting its planned level of service and improve its quality assurance function.

3.124 Since our audit, the Patent Co-operation Treaty, which started to come into effect in 1990, and the implementation of the new Patent Act (1987) have significantly changed the patent application and examination process. The Department has also continued the development of the Canadian Automated Patent System (CAPS), which is expected to be fully operational by 1996.

3.125 In order to respond more effectively to demands in the area of patents as well as to its other responsibilities, the IPD sought and recently received the authority to become a Special Operating Agency (SOA). In the case of the Patent Office, the Department believes that the procedural changes, the development of CAPS, and the flexibility provided by SOA status will allow it to reduce backlogs, assess and meet client needs, develop performance measures and establish a quality control function. The Department also believes that SOA status will provide the means to fully address our concerns about service standards and overtime use in another part of the IPD, the Trade-marks Office.

3.126 While the Department's actions to date seem reasonable and appropriate, the concerns underlying our observations and recommendations remain unresolved at the time of our follow-up.

Corporations Directorate

3.127 The Corporations Directorate regulates the creation and existence of federally incorporated corporations. In our 1990 audit we found that it had no procedure for assessing the currency or accuracy of information it held. Our follow-up found that this concern has not yet been resolved. However, the Directorate has initiated a major automation project to manage the estimated 14 million documents it currently holds. The Department believes that, when fully implemented, the data and imaging system (DISCO) will provide quicker processing and allow for the redeployment of resources from clerical functions to compliance and quality control related functions.

We found that the Department has addressed most of the recommendations that we made in 1990.

Protection of Information

3.128 In our audit we found physical security risks to the information held by the Patent Office, the Trade-marks Office, and the Corporations Directorate. These risks have not yet been fully addressed, although the Corporations

Directorate has taken steps to control access to its premises. The Department expects that the automation initiatives in these three areas will resolve the issue of information protection.

Marketing Practices Branch

3.129 The Competition Act prohibits misleading advertising and other deceptive marketing practices. Our audit found that the proportion of possible violations of the Act that were investigated had dropped well below the objective set by the Branch and that investigations were becoming increasingly costly. We also found weaknesses in the Branch's ability to set investigation priorities. We recommended that the Bureau review current practice and develop a strategy to maximize program efficiency and effectiveness.

3.130 The Branch has taken some action on our recommendation, although progress has been slower than expected. Management is developing a strategy in the form of a new business plan that, among other matters, is intended to deal with the issues raised by the audit. Implementation is expected to begin in April 1993. The Branch is also implementing a compliance–oriented strategy to resolve lesser priority cases through alternative (non–criminal) means. Finally, during 1993–94 the Department expects to further consider whether it should recommend amendments to the Competition Act that might, among other things, allow for more effective and efficient administration of the marketing practices provisions.

Department of Energy, Mines and Resources — Surveys, Mapping and Remote Sensing Sector — 1990, Chapter 17

Background

3.131 In our 1990 chapter on the Surveys, Mapping and Remote Sensing Sector, we made observations and recommendations with regard to the need for analyzing options for the future of its digital mapping program.

3.132 Between 1980 and 1990, the Department spent about $33 million dollars on establishing a National Topographic Data Base (NTDB). The NTDB attempts to deal with the question of how to produce or revise paper maps efficiently, while meeting the emerging need for digital map information.

3.133 At the time of our audit, we could not find adequate plans and analysis guiding the development of the NTDB and substantiating its contribution to the Sector's overall objectives. We also questioned the efficiency gains and cost justification for digital stereocompilation of topographic data.

3.134 Our follow–up focussed on the action taken by the Department of Energy, Mines and Resources in response to our recommendations and observations. We reviewed studies and supporting documents supplied by the Department and conducted interviews to substantiate its progress since 1990.

Conclusion

Management has conducted the studies and analysis suggested in our 1990 report.

3.135 We found that management has conducted the studies and analysis suggested in our 1990 report. The Sector has also established targets and performance indicators related to its digital mapping activities.

Observations

3.136 One of our recommendations suggested that the Department conduct a study to define the essential federal and national topographic data requirements with cost–benefit analysis on the various options for meeting these requirements.

3.137 The Sector conducted a user needs study that identified user requirements and four alternatives for meeting them, as well as a cost–benefit analysis for each. The study also suggested that the Department's "program with respect to topographic information must change to be more in line with user needs and emerging technologies."

3.138 The Department has considered the conclusions and recommendations of the user needs study and is acting upon them. Specifically, the Sector has indicated that it will be curtailing its stereocompilation activities.

3.139 Our second recommendation in 1990 involved the identification and monitoring of strategic milestones and measurable benefits for the digital mapping program over the next 10 years. The Sector has now established targets and performance indicators which will be used in developing its multi–year operational plan and in monitoring results against the plan.

Department of the Environment — 1990, Chapter 18; Conservation and Protection — 1991, Chapter 11

Background

3.140 In 1990 we identified a number of deficiencies in the Department's program evaluation activities. We stated that the Department needs to improve the coverage and quality of its evaluations and to report these evaluations in a fair and balanced manner. We also commented on the jurisdictional complexities relating to environmental matters, noting that Canada lacks a comprehensive strategy for dealing with the environment. As well, we reported some of our preliminary findings with respect to the slowness of implementation of the Canadian Environmental Protection Act (CEPA). We stressed the need for co–ordinated environmental action, including enforcement, by all levels of government.

3.141 Our 1991 audit report went more deeply into the Department's compliance and enforcement activities and its implementation of the Canadian Environmental Protection Act and of sections 36 to 42 of the Fisheries Act. We reiterated the need for the federal government and the provinces to clarify their respective roles and responsibilities for compliance and enforcement activities. We pointed out that priorities for these activities had not been clearly defined; that they were not adequately monitored and evaluated; and that there was insufficient information for their management and control.

3.142 In 1991 we also reported on weaknesses in the strategic and operational planning of the Great Lakes Action Plan for the clean–up of the Great Lakes. At the operational level, for example, there was no Remedial Action Plan strategic framework, containing realistic goals and deadlines, to guide the implementation of the 17 Remedial Action Plans for areas of concern. In our opinion, such deficiencies have slowed progress in dealing with the serious toxic pollution of these water bodies.

3.143 Finally, we reviewed the quality of information presented in three important accountability documents, with an emphasis on reporting on compliance and enforcement activities and the Great Lakes Water Quality Agreement. We found several deficiencies in reporting, particularly with respect to planned and actual results.

Conclusion

3.144 We are encouraged by the Department's positive response to our reports. The Department has made satisfactory progress in dealing with most of the observations and recommendations. In some cases, however, there is still more to be done. The observations below highlight areas where significant progress has been made and those where we feel improvements are still needed.

Observations

Program Evaluation

3.145 The Department now has plans to obtain effectiveness information on most of its significant programs. We found that the quality of the 1991 evaluation of Ice Services was significantly better than that of four of the five evaluations examined in our original audit. However, there is still progress to be made in the areas of sampling and questionnaire design and on the range of issues to be addressed.

Canada now has a comprehensive environmental strategy.

Comprehensive Environmental Strategy

3.146 With the release of the Green Plan in December 1990, Canada now has a comprehensive environmental strategy. Over the next few years, this Office will be auditing several programs under the Green Plan.

Great Lakes Water Quality Agreement

3.147 We are pleased to note the Department's positive response to our observations and recommendations dealing with the Great Lakes Water Quality Agreement. The Department has prepared in draft the "Federal Provincial Strategy for the Great Lakes Ecosystem" and is in the process of consulting non–government organizations (NGOs) and stakeholders before finalizing it. The document creates a strategic framework within which all aspects of the program, including the development and implementation of Remedial Action Plans (RAPs), are integrated. While it includes a timetable for the completion of RAP reports, each of these will have more specific objectives and deadlines once responsibilities and financial commitments have been determined. As noted below, we remain concerned about program co–ordination.

3.148 Program co–ordination. The Inter–departmental Committee on Water (ICW) has formed a RAP Steering Committee that will advise it on both policy and operational matters and improve interdepartmental co–ordination. This is a positive step. However, only one ICW meeting (November 1991) and one Steering Committee meeting (February 1992) have taken place since our 1991 audit was completed. The benefits gained from this process change could be lost if the Department does not show leadership by setting the pace of meetings, impressing on members the importance of personal participation and setting agendas to ensure timely decisions are taken on important policy and operational issues.

The Department still has not identified standards of environmental quality or the degree of compliance required to achieve a given level of environmental quality.

Compliance and Enforcement Activities

3.149 Subsequent to our 1991 audit, the Department established the Office of Enforcement. The Office is dedicated to enforcing the environmental regulations, training enforcement personnel and monitoring enforcement activities and compliance levels. The Office has begun to formulate a set of standardized enforcement guidelines and has set priorities for inspection as part of the National Inspection Plan for 1992–93. Also, it has significantly improved its ability to enforce environmental regulations. However, the Department still has not identified standards of environmental quality or the degree of compliance required to achieve a given level of environmental quality, nor has it assessed the effectiveness of existing regulations. The Department is developing alternative methods for achieving compliance including the use of economic instruments, educational programs and promotions and pollution prevention initiatives. The Department still has insufficient information on compliance and enforcement. Its computerized information system is, however, expected to be in operation by December 1993.

3.150 Regulation of toxic substances. In 1991 we noted that the priority substances assessment program had completed reports for only three of the forty–four substances on the priority list and that the Department would not complete the remaining reports by 1994 as originally scheduled. Since then the Department has significantly advanced the number of reports nearing completion. The Department has indicated that the release of reports for sixteen substances will be completed by March 1993 and the assessment of the remaining substances will be completed on schedule before February 1994.

3.151 Since the 1991 audit, a comprehensive management system has been implemented to support the program by tracking progress and providing the information needed to anticipate, identify and resolve problems on an ongoing basis.

Provincial Court Decision on the Canadian Environmental Protection Act

3.152 The impact of the 7 August 1992 ruling of the Superior Court of Quebec on the administration of CEPA is unclear at this time.

Accountability Reporting

3.153 The Report to Parliament on the Administration and Enforcement of the Canadian Environmental Protection Act (CEPA). The Department has made significant improvements to the 1991 CEPA report. It provides more complete information on the Department's activities under the Act and answers more of the reader's questions. However, the report still does not point out the extent to which the Department is meeting the objectives of the Canadian Environmental Protection Act. In order to measure the achievement of its objectives, the Department is developing an evaluation framework for a parliamentary review of the administration of CEPA in 1993.

3.154 Part III of the Estimates for 1990–91 and 1991–92. In its 1992–93 Estimates the Department responded to several of our concerns about completeness of information and providing information on significant constraints to program success. There is still room for improvement in the reporting of planned and actual performance in terms of results and related resources. The Department's Part III Estimates provide some broad information on proposed government–wide Green Plan spending targets and expected results and refers the reader to the progress report entitled "Canada's Green Plan — The First Year" for more detailed information on the government–wide Green Plan. We have not audited this latter report, but we have noted that it does not provide a comprehensive picture of planned and actual Green Plan spending.

Department of Indian Affairs and Northern Development — Northern Affairs Program — 1990, Chapter 19

Background

3.155 In 1990 we reported on how DIAND carries out its legislative mandate for managing Crown lands in Canada's North. We focussed on selected aspects of land, water and mineral resource management. We also reported on the Department's disclosure of the costs of comprehensive land claim settlements. DIAND generally concurred with our recommendations for improvement.

3.156 This year, we enquired into the Department's progress in implementing our 1990 recommendations. In March 1992, it reported to us on several initiatives it had undertaken.

Conclusion

3.157 In general, it would appear that DIAND has made satisfactory progress in its reported initiatives respecting water and mineral resource management and cost disclosure of comprehensive land claim settlements. However, we are not in a position to comment on the effectiveness of these initiatives, because some of them had not been fully implemented at the time of our follow–up enquiry. We will consider performing a further review when appropriate.

3.158 With respect to land management, we are unable to determine whether or not DIAND's current approach to land use planning is reasonable in the circumstances.

3.159 We noted in our 1990 audit that the ways in which land is used can involve many complex decisions. These relate to issues such as development opportunities, environmental protection and threats to aboriginal cultures. In our view, although approved land use plans may not provide complete solutions, their absence could mean that these issues are not being appropriately addressed.

3.160 During our follow–up review, DIAND informed us that due to resource constraints, the Land Use Planning Program for the North was wound down in early 1991. This resulted in delays in the planning approval process. DIAND further indicated that land use planning functions would continue through the comprehensive land claims process and other departmental activities.

3.161 We therefore asked DIAND to provide information on the extent of land use planning coverage from all significant sources. DIAND responded that approximately 33 percent of the Northwest Territories and 10 percent of the Yukon are covered by approved land use plans and/or by a land use planning component in a land claim settlement. The extent of land use planning through other departmental activities was not reported to us.

3.162 We further noted that DIAND has not conducted a recent evaluation of how well land use decisions are being made and implemented. This is partly because comprehensive land claim settlements were finalized only recently. Consequently, the appropriateness of the current approach through the claims process and other activities is largely unknown.

Department Of National Defence – Human Resource Management – 1990, Chapters 20, 21, 22 and 23

3.163 This report focusses on recommendations made in 1990 in eight main areas: the military personnel management system, merit assessment, military conditions of service, commissioning plans for officers, senior officer training, official languages, training efficiency and economy, and medical support. It also covers recommendations made in 1984, 1987 and 1988 on departmental performance reporting.

Conclusion

3.164 Our follow–up audit indicated a varied response to our recommendations. While progress on some has been satisfactory, in several cases much remains to be done.

Observations

Military Personnel Management System

3.165 In our 1990 audit we reported that the Department did not have the management tools needed to understand the dynamics of the human resource management system, and the long–term effects of various policy decisions.

3.166 The Department of National Defence (DND) has since acquired a human resource management modelling and simulation capability. This has the potential to resolve most of the issues we raised concerning the overall management of the process.

3.167 In 1984 and again in 1990, we recommended that DND review its Military Occupational Classifications (MOCs) structure in the context of longer–term force development. The Department has initiated a military occupation structure review. This review will rely on a definition of "military essentiality" and is intended to produce a comprehensive management tool that can be used for force structure design; it is intended to redress imbalances between officers and non–commissioned members, operations and non–operations within MOCs, and support and operations classifications. DND is now in a position to utilize its recently acquired modelling and simulation capability to assess the long–term personnel policy and force structure impacts from this initiative.

Merit Assessment

3.168 In 1990 we recommended that the merit assessment process be subject to a major review.

3.169 National Defence has initiated studies on some aspects of changes in the officer merit process and plans to begin an in–depth review of the merit system. We intend to follow–up on the Department's progress at a later date.

Military Conditions of Service

3.170 Our 1990 chapter on military conditions of service examined a range of services and benefits intended either to adjust for special military conditions or to develop military commitment and a military ethos. We noted that direct pay and allowances alone cost the Department $3.3 billion, or 29 percent of its 1989–90 budget.

3.171 Since 1990, National Defence, with the support of the Treasury Board Secretariat has acted positively on our recommendations. The roles and responsibilities of the National Defence/Treasury Board Secretariat Advisory Committee on Military Pay and Other Conditions of Service have been revised. A broadly based review of key elements of conditions of service is now under way. Given the current context of widespread changes to the Public Service, this issue may be the subject of an in–depth audit as early as 1995.

Commissioning Plans for Officers

3.172 Our 1990 Report recommended that National Defence periodically evaluate the efficiency and effectiveness of its commissioning plans. We pointed out that the Department spends between $18,000 and $47,000 per student per year, depending on whether the officer cadet is sent to a civilian university or to a military college. The Department had never made an overall evaluation of cost–effectiveness for commissioning options, nor had anyone been given responsibility for doing so.

3.173 Our follow–up audit found that, although a committee had been established to co–ordinate the administration of the plans, no single office was responsible. An evaluation of the plans has been initiated, though not completed.

Training for Senior Officers

3.174 Our 1990 audit identified a lack of training for senior and general officers in war–fighting skills required to command large formations. We identified a need for the Department to provide more operational command skills training and employment experience.

3.175 Since our 1990 chapter, the Department has taken, or has made plans to take, a number of actions to address deficiencies.

- The "Rendezvous" series of major land force exercises has been

National Defence is now in a position to utilize its recently acquired modelling and simulation capability to assess the long–term personnel policy and force structure impacts from this initiative.

The roles and responsibilities of the National Defence/ Treasury Board Secretariat Advisory Committee on Military Pay and Other Conditions of Service have been revised.

modified to increase war-fighting training for senior officers.

- Senior officers have been sent on the British Army Higher Command and Staff Course for the last two years.
- The Canadian Forces will offer a Joint Warfare Seminar of three to five days next winter at the Canadian Forces Command and Staff College. This is intended to be the first step to scope the overall requirement for senior officer operational training.
- The Department plans a review of formation commander training needs.
- A course for academic training in military history and the art of war has been proposed for senior and general officers.

3.176 Nevertheless, the Department recognizes that because of its small force and funding constraints, the proposed training still falls short of that provided by other armed forces.

Official Languages Training

3.177 Background. In our 1990 Report, we recommended that National Defence redefine the goals of its Official Languages Program in terms of the number of bilingual positions required and the proficiency levels needed to meet clearly defined operational requirements.

We reported that the Official Languages Program had cost the Department about $500 million since 1980 and was expected to cost $1.4 billion over the next 15 years. There were 7,600 individuals on language training in 1990–91.

3.178 We reported that this program had cost the Department about $500 million since 1980 and was expected to cost $1.4 billion over the next 15 years. There were 7,600 individuals on language training in 1990–91.

3.179 The Department's Official Languages Program is operated separately from that of the Public Service Commission of Canada because of unique National Defence operational requirements. DND must also respect the provisions of the Official Languages Act.

3.180 Additionally, National Defence has developed an internal policy known as the "bilingual officer corps". This does not require that all officers be bilingual, but that the officer corps must be structured in such a way that all bilingual positions can be manned continuously by bilingual people. Under this policy, starting in 1997, promotion to the rank of lieutenant–colonel will normally be restricted to bilingual officers.

3.181 Development of management goals. In response to several of our findings, the Department told us that it would work with Treasury Board officials to develop a Letter of Understanding to set clear and measurable objectives for the official languages training program, including the refinement of attainable goals. A Letter of Understanding was signed by the Department and the Treasury Board in June 1991 and contains commitments to improve management and reporting in many areas, including needs definition, utilisation of bilingual personnel, posting, and planning and control. At the time of our follow–up, the Department had not yet reported to Treasury Board officials on their progress. Our follow–up reflects the situation as of summer 1992.

3.182 Policy on definition of needs. Since 1990 the Department has responded to our recommendations by reviewing its policy on the identification of bilingual positions and is in the process of redefining its bilingual requirements to comply with the Official Languages Act. The bilingual officer corps policy has not been re-examined yet.

Our follow–up found that the efficiency and effectiveness of language training programs have not improved.

3.183 Program management still inefficient. Our follow–up found that the efficiency and effectiveness of language training programs have not improved. In order to meet the bilingual officer corps policy, DND has given all officers the opportunity to become bilingual. This approach appears very expensive and at the current level of resources does not seem to be an advantageous way of meeting DND's linguistic obligations. We found that in 1990–91 language programs produced only about 30 percent of what was required and projected under the 1990 plan. The Department recognizes that it is spending a great deal of resources just to maintain the status quo and that a fundamental review of language targets and implementation options is needed.

The Department recognizes that it is spending a great deal of resources just to maintain the status quo and that a fundamental review of language targets and implementation options is needed.

3.184 Our follow–up also observed that language training programs continue to have many deficiencies.

- Annual goals specifying how many people should be qualified at particular linguistic levels are not determined.
- Accountability for the achievement of these goals is not clearly defined.
- The Department's plans still do not focus training resources to address the acute shortage of bilingual Anglophones. We noted in 1990 that the Canadian Forces' language system is designed to offer a low level of training to many, rather than to train fewer individuals to the minimum proficiency level. In 1989 the 9,000 Anglophones at the language level closest to becoming bilingual were not given priority access to resources that would have enabled them to become effectively bilingual. In 1990–91, 75 percent of the student population was still registered at the beginner level of the program.
- DND's new decentralized program for 4,000 students across Canada does not have adequate performance data on students, such as success rate, attrition rate and number at each proficiency level. Without such data, the Department cannot properly manage the language program or report reliably on its full costs.
- Only 24 percent of the candidates who took the 1990–91 non–commissioned member basic French course qualified as bilingual.

3.185 Senior officials told us that they are planning certain corrective measures. They intend to assign greater priority to increasing the skills of those who are close to being bilingual, to improve accountability at all levels, to increase resources for program monitoring and to increase funding for the decentralized program. These measures should enhance the efficiency and effectiveness of language training programs, but at this time they cannot determine by how much.

3.186 **Bilingual posting priorities not implemented.** DND has not implemented our recommendation to incorporate bilingual posting priorities into its language training. There is still no departmental posting policy to assign bilingually trained individuals from all courses to positions designated as bilingual, while respecting operational tasking priorities. The current departmental bilingual manning policy affects only the 250 or so graduates each year of the continuous French course. Although this course lasts a full year and costs over $80,000 per person, in 1990–91 only 66 percent of its graduates were actually assigned to a bilingual position.

DND has not implemented our recommendation to incorporate bilingual posting priorities into its language training.

3.187 Our audit indicated a 1.4 percent increase in the number of bilingual positions filled with bilingual personnel in 1989 and a 0.2 percent increase in 1990, even though the Department's objective is 5 percent per year.

3.188 **The language factor in the merit system.** In 1990 we reported that the Treasury Board had not provided direction on how to integrate language skill requirements into the merit assessment process for an institution such as the Canadian Forces. National Defence has adopted a policy of awarding merit points to individuals for having been motivated to learn the second language as well as for actually

The current system appears inadequate to motivate enough individuals to become proficient in their second language by 1997.

The Department still needs to re-evaluate its Official Languages Program implementation in order to better respond to identified needs. Our findings are supported by officials of the Office of the Commissioner of Official Languages.

acquiring second language skills. Our follow-up indicates that consultations between Treasury Board and departmental officials would be necessary to develop policies suited to institutions that appoint individuals to rank rather than position.

3.189 Our 1990 audit stated that there was a need for clearer guidelines for merit boards on how to apply a language factor in merit assessment. In order to gauge the progress made, our follow-up audit examined the current guidelines used to assess the language factor. We also reviewed merit board files of majors promoted to lieutenant-colonel in 1991, to assess the boards' application of the language factor.

3.190 Our follow-up could find no rationale for the merit assessment language factor of 5 percent, nor how it contributes to the Department's goal of a bilingual officer corps by the year 1997. The merit system did not establish a minimum requirement in terms of language capability, and awarded the same value or greater to a candidate's perceived motivation to learn the second language as to a candidate's actual bilingual capability.

3.191 The current system, including the low percentage of merit points, the lack of minimum requirements and the disproportionate importance attributed to motivation, appears inadequate to motivate enough individuals to become proficient in their second language by 1997. In fact, our follow-up review of promotion files indicated no significant increase since 1989 in the percentage of bilingual Anglophone majors promoted to lieutenant-colonel.

3.192 Our follow-up also found that the application of the criteria was seriously inconsistent within and between merit boards. We found that over 50 percent of the time, the bilingual score given to individuals did not follow the guidelines or did not compare with scores awarded to their peers. Our examination also indicated that merit assessment included standards that were no longer valid. One quarter of lieutenant-colonel promotions were based on language test results that had expired or on no data at all.

3.193 **Minister's study group established.** At the time of our follow-up, the Minister of National Defence set up a study group to report on the use of French and Francophone participation in the Canadian Forces. We held discussions with the study group and are keeping abreast of its activities.

3.194 **Conclusion.** Our follow-up audit indicates that the Department still needs to re-evaluate its Official Languages Program implementation in order to better respond to identified needs under the Official Languages Act and ensure effectiveness and efficiency in its posting and merit systems, while respecting "sharp-end" operational priorities. Our findings are supported by officials of the Office of the Commissioner of Official Languages.

Training Efficiency and Economy

3.195 In 1990 we found that 62 percent of individual training delivered by the Canadian Forces Training System was not relevant to trainees' present jobs or duplicated what they already knew. This training cost $165 million per year. While difficulties of this type would be present in any large training system with complex requirements, we recommended that the Department review its processes for planning and delivering individual training to confirm that the system is efficient and responsive to the needs of users, and that it regularly review the relevance of course content.

3.196 In June 1992 the Department began a Financial Accountability in Individual Training initiative intended to link training more directly to operational requirements, delegate authority to those actually responsible for training, provide adequate cost and budget information to training managers, and carry out verification of training. Departmental officials told us that positive results from this project are not expected before three or four years.

3.197 At present, while reviews of course content through validations are being done by all Commands, the number of completed validations remains low. In 1990–91, 40 courses were validated out of approximately 1,700 for the whole Canadian Forces. The Department plans to complete 51 validations in 1991–92 and another 54 in 1992–93. Officials told us that they expected the number to increase when new validation tools, now under development, become available. However, the Department does not know the extent to which it has been able to eliminate unnecessary training.

3.198 We recommended in 1990 that the Department compare costs between its own school system, civilian colleges and institutes of technology. We reported that National Defence should identify where Canadian Forces schools cost more and should use this information to reduce its costs. By way of example, in 1990 we reported that it cost $265,352 for a CF Fleet School to train a marine engineering technician, whereas it cost $71,923 in the community college system.

3.199 The Department has contracted out training in a number of significant, but isolated, initiatives. It has also amended its training policy to make option analysis a requirement, despite not yet having applied it on a case–by–case basis. In addition, the Financial Accountability in Individual Training initiative is designed to encourage decision makers to select the most economical training method by holding them financially accountable.

3.200 In 1990 we recommended that National Defence ensure that equipment contracts require that the type and quality of training provided will meet departmental needs, before acceptance of the product. For example, in 1990 we reported concerns that the Canadian Patrol Frigate Project did not require the contractor to provide adequate training capacity for the first six ships.

3.201 Since 1990 the Department has changed its standard contract to require contractors to specifically state what course evaluation and validation will take place. However, it still does not require that courses be validated before payment is made, as we recommended.

3.202 Our 1990 report recommended that National Defence increase efforts to synchronize training with delivery of equipment and ensure that opportunity costs of non–productive equipment are considered during contract negotiation. The Department has issued instructions that increase emphasis on this issue.

The Department does not know the extent to which it has been able to eliminate unnecessary training.

Medical Support

3.203 The DND medical support system costs at least $230 million per year. Our 1990 audit recommended that National Defence determine the minimum dedicated medical support system needed in peacetime to support unique military needs and to act as a basis for expansion to meet wartime needs. We also recommended that alternatives designed to improve efficiency be considered, since the Department's peacetime medical system costs in our sample were 86 percent higher than the average for similarly sized civilian hospitals.

3.204 The Department is attempting to identify all Regular Force medical support personnel requirements for quick–response forces used to support contingency operations. National Defence continues to have difficulty determining the minimum peacetime dedicated medical support system that could be mobilized to meet multiple contingency needs. The Department has yet to define medical support requirements for circumstances more demanding than contingency operations and to determine how they

National Defence continues to have difficulty determining the minimum peacetime dedicated medical support system that could be mobilized to meet multiple contingency needs.

would be mobilized. Consequently, minimum peacetime medical staff levels to support wartime operations cannot be defined.

The Department has taken positive steps to rationalize its hospital system by downgrading two of its Canadian Forces Hospitals to smaller base hospitals.

3.205 Since our 1990 audit, officials indicated that National Defence reduced expenditures in 1991–92 for medical support by $1.5 million over the previous year. The Department is undertaking a study to identify the optimal means of providing peacetime hospital services in the Prairie and Pacific regions. The Department has taken positive steps to rationalize its hospital system by downgrading two of its Canadian Forces Hospitals (CFHs) to smaller base hospitals. This resulted in a surplus of 59 positions, the majority of which will be used to meet existing and new program requirements within DND. However, the Department's redistribution of 24 positions to other CFHs could increase the peacetime cost per patient. DND has indicated a reluctance to further reduce the size of the medical system until the medical support requirements for contingency operations have been fully identified. The need for an approved force structure for peace and war was identified in our 1984 report and has been the object of follow-up since then. Chapter 18, which deals with the CF Reserves, comments further on this issue.

In 1988 we recommended that DND develop a series of indicators for defence capabilities and peacetime defence performance measures suitable for publication in Part III of the Estimates, but no decision has yet been taken to implement our recommendation.

Departmental Performance Reporting

3.206 Our 1984 Report recommended that DND co-ordinate information on performance measurement, program evaluation, internal audit, and operational feedback, in order to provide comprehensive, timely information to senior officials on the extent to which defence objectives are being achieved and tasks are being carried out.

3.207 The Department considered various alternatives in accountability reporting at National Defence Headquarters, and in February 1990 opted for group business plans. However, our follow-up audit found that Headquarters has still not developed any policy for producing these plans.

3.208 In 1984 and again in 1987 we recommended that the Defence Activity Performance Management System (DAPMS) assign the full range of costs against tasks and provide performance data on support and logistic services. Since that time, National Defence has dropped the DAPMS and developed the Operational Readiness and Effectiveness System (ORES) to report on the operational capability of the Canadian Forces. ORES is based on tasks developed from the 1988 Canadian Forces Development Plan (Provisional). While ORES is a significant step forward, it is not designed to assign costs to tasks, and its data is not yet complete or usable.

3.209 In 1988 we recommended that DND develop a series of indicators for defence capabilities and peacetime defence performance measures suitable for publication in Part III of the Estimates. During our follow-up audit, officials informed us that alternatives are still being actively considered, but no decision has yet been taken to implement our recommendation.

Department of National Revenue Taxation — Enforcing the Income Tax Act — 1990, Chapter 24

Background

3.210 In 1990 we audited the enforcement activities of the Department of National Revenue – Taxation. This chapter was considered in December 1990 by the House of Commons Standing Committee on Public Accounts.

Scope

3.211 Our follow-up review focussed on the actions taken by the

Department of National Revenue – Taxation in response to our recommendations and observations. We reviewed various status reports by the Department, conducted interviews and analysis and examined documentation.

Conclusion

3.212 National Revenue – Taxation has taken action on all of the recommendations and observations in our 1990 chapter. Progress has been reasonable in implementing several recommendations. However, more work needs to be done in other key areas, including filing of information slips on magnetic media, and research to determine the effectiveness of present enforcement activities.

Observations

Search Warrants

3.213 In 1990 we noted that it often took several months of departmental review to finalize a search warrant, and recommended that the Department find ways to reduce the time required. The Department has responded by moving the authority to approve search warrants to the directors of most field offices. This process should be completed by November 1992. The Department believes that this change will result in a significant reduction in the time it takes to approve a search warrant.

Keeping Parliament Informed

3.214 In 1990 we suggested that the Department make changes in its Estimates Part III. The Department has significantly improved its presentation of information in Part III. This topic is covered in more detail in Chapter 6 on Information for Parliament.

Selection of Taxpayers for Enforcement Activities

3.215 Our 1990 Report suggested that the Department could improve the effectiveness of its selection of taxpayers for enforcement actions. Since that time the Department has increased training and its use of automated selection methods to address this concern.

Filing of Information on Magnetic Media

3.216 In 1990 we noted that the rate of filing of T4s and T5s on magnetic media was quite low. We suggested that the Department attempt to increase the rate to at least 80 percent and consider making magnetic media filing mandatory if reasonable levels of voluntary compliance were not being achieved. The Department has made progress: the proportion of T5s on magnetic media has increased from 38 percent in 1990 to an estimated 66 percent in 1992. The Department expects to meet a goal of 80 percent compliance in the 1993 taxation year.

National Revenue – Taxation has taken action on all the recommendations in our 1990 chapter. However, additional work needs to be done in some key areas.

3.217 Improvement in the rate of filings for T4s on magnetic media has been slower. Filing has increased to 27 percent in 1992 from 20 percent in 1990 but the vast majority of T4s are still filed manually. The Department has stated that it expects voluntary rates of filing to increase to 40 percent in 1993 and 43 percent in 1994. It has also committed to reviewing the need for mandatory magnetic filing at the end of 1993.

Additional Research

3.218 In 1990 we recommended that the Department perform more research to assist development of enforcement policies and practices and to provide feedback on existing activities. The Department cites several areas where additional effort has been placed in the last two years. However, this effort has been more directed to areas other than those noted in our audit observation. For example, the Department has indicated that its recent efforts have gone into areas such as client satisfaction reviews and additional consultations with various advisory groups. Little recent work has been done in the area of research to determine the effects of the Department's enforcement activities on the behaviour of taxpayers. Without such research, the Department cannot assure itself that its present enforcement policies and practices are as effective as they could be. The Department has committed to reviewing its research operations and requirements.

Human Resources

3.219 In 1990 we recommended that the Department improve its human resource information and planning systems and strengthen the training of its personnel. Since our audit, the Department has taken several steps to implement these recommendations. It has updated the training profiles of its enforcement personnel. In the spring of 1992 it started a process designed to determine the gap between the training employees currently have and the amount they should have been given. It has also embarked on the development of a new Personnel Management System. The first part of this system became operational in the spring of 1992. Current plans call for the system to be in full operation by the fall of 1994.

Office of the Superintendent of Financial Institutions – 1990, Chapter 25

Background

Progress has been slower than expected in several areas.

3.220 In 1990 we reported on three activity areas of the Office of the Superintendent of Financial Institutions (OSFI): deposit–taking institutions; regulatory policy; and management services. We recommended that OSFI ensure that procedures are fully in place for monitoring institutions; improve risk assessment processes relating to the solvency and soundness of deposit–taking institutions; strengthen procedures and practices with respect to reliance on external auditors; improve compliance procedures; give higher priority to achieving better co–ordination with the Canada Deposit Insurance Corporation and provincial regulators; and install better staff training processes.

Conclusion

3.221 In our follow–up, we found that OSFI has taken steps to address most of our recommendations. However, in several areas progress has been slower than expected. We recognize that heavy demands have been placed on OSFI's resources because of recent difficulties in some segments of the financial services sector.

3.222 We were advised by OSFI that the new legislation governing financial institutions, which was proclaimed this year, has also affected the timing and method of implementation of many of our recommendations.

3.223 As we stated in our 1990 chapter, the importance of effective and timely monitoring cannot be overemphasized and OSFI should continue to make every effort to further strengthen its role.

Observations

Self–governance and Self–regulation by Deposit–taking Institutions

3.224 In our 1990 chapter, we recommended that OSFI formalize, in its examination framework, its expectations of the boards of directors and operating management of deposit–taking institutions in respect to self–governance and self–regulation. OSFI advised us that it had not acted on this recommendation because of the anticipated changes in the responsibilities of boards of directors contained in the new legislation governing deposit–taking institutions. OSFI said that it is now in the process of making appropriate additions to its examination framework in respect of self–governance and self–regulation to reflect the thrust of the new legislation.

Monitoring of Deposit–taking Institutions

3.225 In 1990 we made several recommendations to improve OSFI's monitoring procedures.

3.226 Specifically, we recommended that OSFI have access to a comprehensive database on deposit–taking institutions. OSFI has recently prepared a plan to develop such a database and expects its implementation to begin shortly. In the meantime, OSFI is using alternative sources of information for monitoring institutions.

Financial analysis needs further strengthening.

3.227 In response to our recommendation that OSFI conduct regular financial analysis of individual deposit–taking institutions to identify emerging risks, we noted that more financial analysis is being done now than before. However, analytical procedures have not been formalized to ensure regularity and consistency. In some cases, the breadth of analysis carried out and provided to the examiners is not sufficient to permit full utilization of this information by them. Also, in several cases, data obtained and used for financial analysis were not current.

3.228 We recommended that OSFI strengthen its procedures for conducting studies of system–wide and sectoral issues. In our follow–up, we noted that there continues to be a need for more extensive and pro–active coverage of such issues. OSFI has recently established a program for conducting studies in the 1992/93 fiscal year; if implemented, these would provide a more comprehensive coverage of relevant issues.

3.229 We were unable to fully assess the implementation of our recommendation that OSFI's examiners periodically contact the management of institutions. We found that, except in the case of troubled institutions, few such contacts were documented in OSFI's files. However, OSFI advised us that its examiners were indeed making periodic contacts, even though limited records were being maintained on file.

3.230 With respect to our recommendation for the consolidation of procedures for troubled institutions, OSFI has recently prepared a crisis management plan and has improved the co–ordination between its investigations unit and its examiners in order to achieve a more concerted monitoring effort.

Risk Assessment Process

3.231 In 1990 we recommended that OSFI strengthen its procedures for assessing risk in the specialized areas of treasury and EDP and securities subsidiaries of deposit–taking institutions. We also recommended that there be detailed criteria established for the specific approach used by OSFI in measuring the risk profile of a deposit–taking institution.

OSFI needs to further improve its coverage of treasury and EDP risk in deposit–taking institutions' operations.

3.232 In our follow–up, we observed that OSFI had made some improvements in the coverage of treasury and EDP risk in terms of the number of institutions examined and the quality of examination. OSFI, however, needs to further improve its coverage of these high–risk areas by rigorously examining a greater number of institutions. In respect of security subsidiaries of deposit–taking institutions, OSFI has developed and implemented improved procedures for assessing risk from their operations. As to the overall approach to measuring the risk profile of an institution, OSFI has only recently developed the detailed criteria needed for this purpose. The approach is being field–tested.

Reliance on External and Internal Auditors

3.233 In response to our recommendations on reliance, OSFI examiners have improved their understanding of the differences between the role of external auditors and the mandate of OSFI in conducting examinations. In recognizing the differences, OSFI is now conducting more independent work in high–risk areas such as treasury and EDP. However, the examiners do not always state how the reliance has affected the scope of their examination work. With respect to reliance on internal audit, we noted some improvement in OSFI's procedures. However, in a number of cases, there continues to be a lack of information on file on the extent to which internal audit has covered significant internal controls and how it has affected the scope of OSFI's examination work.

Canadian Payments Association (CPA)

3.234 We recommended that OSFI carry out a full scope examination of CPA. OSFI has not done this. However, it has obtained a legal opinion which states that its present examination is sufficient to meet the mandate given it under the Canadian Payments Association Act.

Compliance with Legislation

3.235 We recommended that OSFI improve its compliance testing procedures. OSFI has made some improvements in compliance testing. With respect to banks, however, it relies primarily on external auditors for verification of compliance, with limited testing carried out by its own examiners. Before such reliance is placed, OSFI should determine the nature of compliance work done by external auditors and its adequacy for OSFI's purpose. OSFI advised us that the delay in implementing our recommendation was due to a decision not to revise its compliance procedures until the new financial services legislation had been introduced. It has further stated that since this has now occurred, it has established a compliance division to provide a more co–ordinated approach to compliance testing.

Co–ordinating Efforts with the Canada Deposit Insurance Corporation (CDIC) and Provincial Regulators

3.236 We recommended that OSFI immediately enter into a memorandum of understanding with CDIC and co–ordinate, as appropriate, supervisory roles with provincial regulators to achieve consistency in supervision.

OSFI and CDIC have been working on a memorandum of understanding since 1989 but an agreement has not yet been signed.

3.237 OSFI and CDIC have been working on a memorandum of understanding since 1989. A number of drafts have been prepared, but an agreement has not yet been signed, as some issues are still to be resolved.

3.238 In 1991 OSFI, under the lead of the Department of Finance, joined its provincial counterparts in an effort to harmonize supervision of regulated financial institutions. There is a need for continued effort by all parties.

Professional Development and Training

3.239 We recommended that OSFI give immediate attention to developing and implementing improved training plans for its staff. OSFI has strengthened its professional training and development by conducting a needs analysis, allocating budgets to line managers and providing some of the necessary training to staff.

Security of Information and Conflict of Interest

3.240 We recommended that OSFI conduct a risk and threat assessment of its operations and implement proper procedures to safeguard security of information. In addition, we recommended that its procedures relating to conflict of interest be improved.

3.241 OSFI prepared a threat and risk assessment of information systems in 1991 and an implementation plan in May 1992. However, procedures to ensure information security are not yet fully in place. We noted that procedures relating to conflict of interest have been improved.

Department of the Secretary of State — Citizenship — 1990, Chapter 28

Background

3.242 Our 1990 audit of the Department of the Secretary of State covered the Citizenship Registration activity and grants and contributions in Citizenship Development. We also looked at information for Parliament on these two activities.

3.243 **Organizational change.** Citizenship Registration and Promotion activities were transferred from the Department of the Secretary of State to the Department of Multiculturalism and Citizenship, following its establishment 21 April 1991. The organization of the new Department was approved by Treasury Board in December 1991. The Citizenship Development activity (now called Social Development) remained at Secretary of State.

3.244 **Scope.** Our follow–up reviewed the measures taken by both departments in response to our observations and recommendations. In addition to reviewing formal representations made by management and relevant documentation, we interviewed departmental representatives in national headquarters and in three citizenship courts. We did not visit the Registration Centre in Sydney, Nova Scotia.

Department of Multiculturalism and Citizenship — Citizenship Registration Activity

Conclusion

3.245 Our follow–up indicates that the new Department has either corrected or is taking satisfactory action on most of our recommendations. In particular, the Department has undertaken an important project called the Citizenship Registration System that will address many of our recommendations. This is a new computerized system, budgeted at over $9 million, which is being developed and will be implemented by the middle of 1994–95.

3.246 In addition to initiating the new Citizenship Registration System, the Department has taken some measures to improve its activities. For example, citizenship cards are now more difficult to falsify; the Royal Canadian Mounted Police (RCMP) are notified when, as a result of a request for fingerprints, a citizenship application is abandoned; some citizenship courts are better equipped; new application forms for citizenship and proof of citizenship have been developed; and a pilot project to improve productivity by five percent in the current year has been initiated at the Sydney Registration Centre.

3.247 The Department should pursue its efforts to establish productivity standards for citizenship courts and implement the new Citizenship Registration System as quickly as possible.

The Department should pursue its efforts to establish productivity standards for citizenship courts and implement the new Citizenship Registration System as quickly as possible.

Observations

3.248 **The Citizenship Act needs to be improved.** Our 1990 Report noted that the Department of the Secretary of State had been considering the need for certain amendments to the Citizenship Act since 1985. We were informed by the new Department that a proposal for a new Act was prepared and submitted to the Minister early 1992.

3.249 **Corporate planning process — improvements are necessary.** In 1990 we recommended that the Department of the Secretary of State quantify its operational objectives and link operational planning to strategic planning. Given that the organization of the new Department was approved only in December 1991, no operational plan framework was prepared for 1992–93.

We have been informed that the planning exercise for 1993–94 has started.

3.250 **No standards established for turnaround time.** We had noted the absence of standards for turnaround time to apply for a grant or a proof of citizenship. Standards have since been approved by the Deputy Minister and will become effective when the new Citizenship Registration System becomes operational in 1994–95.

3.251 In the meantime, efforts have been made, in Toronto, to meet a proof of citizenship processing time of one month, through a pilot proof-application centre. The Sydney Registration Centre gives priority to these proof applications.

3.252 **Risk of irregularities in the use of citizenship cards.** In 1990 we recommended that the identification numbers of cards reported lost or stolen be communicated to the Passport Office and Customs and Excise. Although preliminary discussions were held with these departments in 1991, no further action has been taken. The Department intends to resume discussions soon.

3.253 **Problems identifying persons with a criminal record.** In connection with the problem raised by the RCMP, that existing procedures did not positively identify persons with criminal records, we recommended that the routine fingerprinting of all applicants for Canadian citizenship be considered. We note that the Minister for Multiculturalism and Citizenship has decided not to adopt this policy, which would provide positive identification of applicants.

3.254 **Information for Parliament.** We had recommended that Part III of the Estimates reflect the cost of individual elements of Citizenship registration in a way that allows the total cost to be determined, and that it provide performance information. The Department plans to comply with these recommendations for 1993–94.

Department of the Secretary of State — Social Development

Conclusion

3.255 Our follow-up shows that the Department has taken satisfactory corrective measures on the points raised in our 1990 Report, except for our recommendation that it provide performance information in Part III of the Estimates. The Department plans to provide such information for 1993–94.

Department of the Secretary of State — Education Support – 1990, Chapter 29

Background

3.256 In 1990 our audit of the Department of the Secretary of State focussed on all Education Support programs, including post-secondary education support and the Canada Student Loans Program (CSLP). We did not audit the Official Languages in Education Program.

3.257 The Department appeared before the Standing Committee on Public Accounts twice in June 1992. The Committee studied an audit note on the CSLP that was published in our 1991 Report. The Committee also deliberated on a number of elements discussed in Chapter 29 of the 1990 Report.

3.258 **Scope.** Our follow-up included a review of the action taken by the Department in response to our recommendations. We examined management's official response to the Standing Committee on Public Accounts, as well as relevant documents and other reports. We limited our meetings to members of the Department's staff.

Conclusion

3.259 The Department has made satisfactory progress toward undertaking corrective measures in the area of Canada Student Loans Program (CSLP). However, more needs to be done in formalizing agreement with provinces. We stress that amendments to the Canada Student Loans Act and Regulations are urgently needed. On matters relating to post-secondary education support, we note minor progress.

Observations

Post-secondary Education Support

3.260 Objectives. In 1990 we noted that national objectives in post-secondary education had not been clearly defined. Although the government has taken a number of initiatives, and discussions with the provinces have taken place, national objectives in the area of post-secondary education have yet to be formulated.

3.261 Federal co-ordination. The Department has made increased efforts to fulfil its mandate as the federal co-ordinator for post-secondary education, using existing mechanisms and developing new ones as the need arises. In our view, these mechanisms still are not sufficiently comprehensive to meet the mandate.

The Canada Student Loans Program

3.262 Approved ceilings are exceeded. In 1990 we pointed out the need for the Department to establish appropriate controls on authorized ceilings for loan amounts. In our follow-up, we found that loan allocations to provinces had again been exceeded, this time by $165 million for the 1991-92 lending year. The Department has initiated corrective measures in compliance with the legislation.

3.263 Designation of post-secondary education institutions. We had recommended that the Department clearly define what constitutes a post-secondary education institution for the purposes of the CSLP, as well as the eligibility criteria to be used in designating these establishments. The Department and the provinces have jointly developed a policy and criteria for identifying these institutions, which are to be implemented beginning 1993-94 loan year.

3.264 Student loans granted in excess of need. In 1990 we found that loans in excess of need were being granted to students who had made erroneous declarations of their resources or had dropped out of their course of studies. Seven provinces currently apply identification and recovery measures with respect to federal loans in excess of need. Departmental and all provincial officials have agreed, starting in August 1992, to establish mechanisms to be used by provinces in the recovery of federal loans granted in excess of need. In addition, Bill C-76, presently in first reading, will have an effect on reducing interest subsidies, but does not constitute a revision of the Canada Student Loans Act with respect to the recovery of loans in excess of need.

3.265 Monitoring and auditing of loan applications. In 1990 we recommended that what constitutes a satisfactory scholastic standard be clearly defined and that an audit plan focussing on provincially administered activities be developed. The Department and provincial officials have agreed on comprehensive requirements for a satisfactory scholastic standard to be applied for loan year 1993-94. Furthermore, the Department has proposed an accountability framework that includes operational and compliance audits, to be implemented by August 1993.

3.266 Need to improve the management of accounts receivable. In 1990 we pointed out the need to improve the management of accounts receivable. Since February 1992 the Department, in conjunction with National Revenue-Taxation, has established a program to recover defaulted loan money from tax refunds.

A total of $18 million was recovered between April and August 1992. The Department is also negotiating with financial institutions for the adoption of other measures to improve the recovery rate. Other initiatives established by the Department, such as a performance grid, the monitoring of collection agencies and a more active follow-up action process, have increased the 1991-92 recoveries. Such mechanisms, as well as other alternatives that should be developed, are necessary for sound management.

3.267 **High default rate.** In 1990 we found that lenders had made little effort to recover loans that had been granted to students. At the time of our follow-up, discussions were under way with lending institutions with a view to sharing the risks of default. As at 31 March 1992, some $964 million in federal loans were in default and were in collection.

3.268 **Management tools.** All of our audits since 1986 have revealed significant deficiencies in the management information system. We note improvements to the system and we urge the Department to continue this work. The Department and the provinces are currently examining the question of developing a common management system. Talks have been held with the banks concerning electronic data interchange. A program evaluation is planned, and a final report is expected by March 1994.

Information to Parliament

3.269 A number of improvements have been made in the 1992-93 Estimates Part III. The Department, however, has not produced an annual report for the Canada Student Loans Program since 1988. Moreover, the Department should continue to improve the report to Parliament on federal and provincial post-secondary education support in order to better demonstrate the links between financing and objectives.

Department of Transport — Airports — 1990, Chapter 30

Conclusion

3.270 While the Department has had some success with runway expansion, limited progress has been made in other areas. The Department still lacks a clear management strategy and plan for financing capital needs and must still adapt to the deregulated commercial environment.

3.271 **Runway expansion.** In 1990 we noted that after years of planning, runway expansions at Pearson and Vancouver Airports remained unresolved. In June 1992 the runway expansion at Vancouver was approved and announced publicly. An Environmental Assessment and Review Panel has reviewed the plans for runway expansion at Pearson and the Department is awaiting the Panel's recommendation. Construction of runways could take three years to complete.

3.272 **Federal role in airports.** In 1990 we reported that the Department needed to re-examine its role in providing airport services in Canada; it needed to develop criteria setting out the conditions under which federal funding would be provided to airports, and a plan to rationalize federal asset holdings and financial involvement in airports. Terms of reference for a study to address these issues were developed, but the Department is now modifying them to account for local airport authorities as well as other government initiatives.

3.273 The Department also has not yet clearly defined its future strategic role in airports. It has developed a decision model for the use of private sector financing, but not an overall policy framework.

3.274 **Planning.** In response to the need to address the $1.4 billion shortfall over five years between capital needs and funding from traditional sources, the Department has developed a business plan outlining operational and capital requirements and a capital investment plan that outlines the needs of airports over the next five years. The plan now shows a shortfall of $1.8 billion, which includes $1.5 billion for the planned runway expansion and terminal revitalization at Pearson Airport.

3.275 Commuter facilities. The Department has completed construction of a satellite holdroom and walkway for commuter traffic at Halifax Airport, overcoming difficulties that we noted in 1990. The commuter facility project at Vancouver Airport is now the responsibility of the Vancouver International Airport Authority.

3.276 Cost recovery. Many issues that we identified in 1990, such as an outdated landing fee structure, inconsistent application of general terminal fees, shortcomings in the terminal building rental policy and loss of fuel concession fees, were to be addressed by a replacement of the 1978 Cost Recovery Policy. The Department indicates that a decision on a proposed cost recovery policy has been delayed by economic conditions.

A decision on a cost recovery policy has been delayed by economic conditions.

3.277 Regulations. Despite efforts by the Department, regulations have not been revised to allow airports to operate in a more businesslike manner and to provide line managers with a rate and fee setting process that is responsive to market conditions.

3.278 Financial information. We recommended in 1990 that the Department provide line managers with key financial tools, such as a commercial cost accounting system, a billing system and a fixed asset accounting system. The development of an Integrated Departmental Financial System is under way, with core requirements scheduled for implementation in late 1993–94. Completion is expected by 1995–96.

3.279 Parking. We estimated in 1990 that annual revenue losses of $4.5 million could be prevented through improved equipment to control parking revenue. We also observed that the Department was slow in replacing parking meters with newer equipment and estimated that at six airports we reviewed, replacement could save $1 million to $2 million per year. The Department states that upgrading of parking equipment has been delayed at larger airports because of fiscal restraints and impending airport transfers. The Department has replaced meters at some airports, but not at the airports we reviewed.

3.280 In addition, we found in 1990 that airports were losing up to $5 million annually because of tenant parking in public parking structures. The Department states that if public parking continues to grow, some of the tenant parking will have to be moved.

3.281 Post–project review of Terminal 3. In 1990 we suggested the development of an improved methodology for future private sector developments based on a post–project analysis of Terminal 3. The Department states that such a review is nearing completion.

3.282 Long–term financial implications. We estimated that there would be an initial revenue shift of $11 million annually to Terminal 3 above the original $25 million that the Department had forecast because of changes to the project, such as the satellite terminal and the transfer of more airlines to Terminal 3. The Department has since agreed to pay the developer to reacquire control of taxis and limousines at the terminal, resulting in a net cost to the Department. The Department's terminal–related revenues from Pearson Airport for 1991–92 declined by $38 million from the previous year. Of this, $4.7 million was because of reduced passenger traffic. The remaining $33.3 million can be attributed to the operation of Terminal 3.

3.283 Although the Department knows the short–term financial impact of these changes, it still has not analyzed the long–term financial implications. Furthermore, it has not updated its original analysis to determine if benefits from the private sector option exceed the cost of the changes. The impact on revenues of a possible merger of Canada's two largest airlines would also need to be considered.

3.284 Terminals 1 and 2 at Pearson Airport. The Department has requested proposals from private concerns for the renovation and operation of both terminals. It is unclear how Air Canada's prior funding of renovations will be taken into account if a third party operates Terminal 2.

3.285 Airport transfers. We noted in 1990 that the Department will have to manage new risks, such as evaluating the potential financial viability of local airport authorities involved in the transfer of airports. The transfers of airports to authorities in Vancouver, Calgary, Montreal and Edmonton have recently been completed. Discussions with local groups on potential future airport transfers are under way in several other cities.

Studies

Chapter 4

Change and Control in the Federal Government

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Change and Control in the Federal Government

Assistant Auditor General: Bonnie Miller
Responsible Auditor: Bonnie Miller

Main Points

4.1 Public service reform will bring about changes in control at all levels of government. Some proposals would have an impact on how Parliament funds and scrutinizes government operations. The central agencies are already reducing central direction, to minimum basic rules. In departments and agencies, as much authority as possible is to be placed in the hands of front–line employees and managers, along with responsibility for ensuring that controls over the operations and resources entrusted to them are adequate. Public servants at all levels are to be more clearly accountable for their performance.

4.2 This study considers the effect of this reform on control at the levels of Parliament, ministers, central agencies and the departments and agencies that deliver programs to Canadians. It sets out some of the important issues that Parliament and the government need to address in changing the control framework.

4.3 It is well recognized that the timing, nature and location of controls could change. The government needs to make clear the control and accountability framework needed — its nature, what it would comprise, and what measures would be in place — to protect parliamentary control while safely guiding public servants who are being asked to innovate, to take greater risks and to be more accountable.

4.4 The government needs to manage the transformation in control carefully and report to Parliament on its progress. Sustained leadership at all levels of government is needed to carry these reforms through. As part of the change process, the adoption of a contemporary view of control — one that is oriented to achievement — is key in renewing management in the public service. In the chapter we suggest, as a matter of urgency, action steps for government to help ensure a successful transition to better management in the public service.

Introduction

4.5 The government has embarked on a major initiative — Public Service 2000 (PS 2000) — to change the way it manages. Its overall objectives are to improve service to Canadians through better management of people, empowerment and innovation, and accountability for results. These widespread reforms, which affect all aspects of government operations, are designed to place as much authority as possible in the hands of front–line employees and managers, and to reduce to a minimum centrally prescribed rules and regulations.

4.6 The Office of the Auditor General supports the objectives and principles of PS 2000 and believes that the success of the reforms is critical in raising the standards of management practice in the federal government. The government has an obligation to manage the change well. In our 1991 Report, the Office announced its intention to monitor the progress of PS 2000 and to raise questions during the change process that need to be addressed. Our purpose in doing so is to acknowledge the significance of this initiative, to foster discussion, and to make suggestions that can contribute to its success.

4.7 The purpose of this study is to consider the impact of reform on control at the levels of Parliament, ministers, the central agencies, and the departments and agencies that deliver programs.

4.8 Much of the dialogue associated with the PS 2000 initiative concerns the need to move away from excessive, detailed controls. The study identifies the challenges the government faces in forging the control and accountability framework needed for the fundamental management change called for by PS 2000, and sets out some of the important issues that the government needs to address to ensure a safe transition.

4.9 In carrying out the study, we traced the evolution of control in government over the past thirty years and reviewed contemporary concepts of control for large, complex organizations. We consulted public service managers in the regions and in the National Capital, and members of the House of Commons Standing Committee on Public Accounts. We also received valuable counsel from study advisors.

The purpose of this study is to consider the impact of reform on control.

The Meaning of Control

4.10 There is no single, consistent definition of control for organizations. In the narrowest sense it means ensuring that specific procedures are followed. In the broadest sense it means creating the conditions that lead to the achievement of objectives.

4.11 Control is formalized in a variety of ways, including the use of mission statements, goals and objectives, policies and procedures, standards and information reporting. It is informally exercised when the influences are ethics, values, trust or commitment. Having a good balance between the two contributes to effective overall control. Exhibit 4.1 shows possible outcomes from the combination of formal and informal controls.

4.12 In government, control means having reasonable assurance that agreed standards of performance will be met, while achieving probity, value for money and compliance with legislative requirements. Control embraces risk management, in the sense that managing risk helps bring about intended achievement while, at the same time, minimizing unintended effects. Effective control systems are used by public service managers and staff to:

- consistently deliver services at the agreed level of quality, with the information they need for decision making;
- comply with laws, regulations and rules of conduct; and

Control provides the context in which empowerment can be created.

- credibly demonstrate their performance and provide assurance that the resources entrusted to them are used productively and are safeguarded.

4.13 Control is both restricting and enabling, an apparent paradox. It is restricting in that it protects against unwanted events such as waste, lapses of probity, or non–compliance with authority. It is enabling in that it helps ensure that objectives are achieved and provides the boundaries within which public servants can take decisions. Control provides the context in which empowerment can be created.

4.14 Different management responsibilities and risks require different types of control. For example, certain safety–oriented control systems are highly formalized, as in pre–flight checks of aircraft, whereas government's control over the achievement of its environmental goals involves a range of processes.

The Control Framework

4.15 Parliament, ministers, central agencies and departments — from deputy heads to front–line employees — are all part of the control framework. By control framework, we mean the combination of processes and resources that have to be managed to achieve planned results.

4.16 **Parliamentary control.** Parliament's control is its approval of the government's plans to spend, borrow and tax, based on the information it may ask government to supply and the information government offers. The full loop of control — at least in design — embraces Parliament's approval of the Estimates, incorporating the government's program objectives and planned spending, and its later scrutiny of what government has actually achieved and spent.

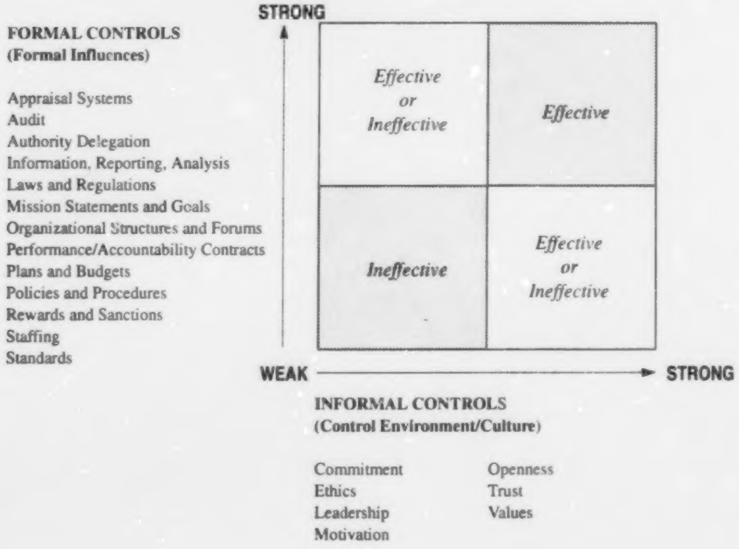
4.17 Parliament passes legislation, including appropriations, that provides authority for the government to act, and sets restrictions and certain expectations for results. Parliament's further influence is through scrutinizing and questioning what the government of the day proposes to do and how, and what it has done.

4.18 **Management control.** In principle and in law, ministers have the ultimate accountability to the House of Commons for the quality of management of the public service. Collectively, they are responsible for the standards by which the public service is managed. Individually, each minister is responsible for ensuring that his or her departmental and agency management practices, controls and stewardship meet these standards. As a practical matter, ministers look to their deputy heads for this purpose.

4.19 Deputy heads down to front–line employees of departments and agencies have the authority and re-

Exhibit 4.1

The Appropriate Combination of Formal and Informal Controls Leads to Effective Control


STRONG
FORMAL CONTROLS
(Formal Influences)
Appraisal Systems
Audit
Authority Delegation
Information, Reporting, Analysis
Laws and Regulations
Mission Statements and Goals
Organizational Structures and Forums
Performance/Accountability Contracts
Plans and Budgets
Policies and Procedures
Rewards and Sanctions
Staffing
Standards
Effective or Ineffective
Effective
Ineffective
Effective or Ineffective
WEAK
STRONG
INFORMAL CONTROLS
(Control Environment/Culture)
Commitment
Ethics
Leadership
Motivation
Openness
Trust
Values

This model suggests that organizations need a combination of formal and informal controls for effective control and this combination will vary from organization to organization.

sponsibility for delivering the programs mandated by Parliament; for complying with various authorities and laws; and for ensuring the appropriate stewardship of public resources entrusted to them. They are expected to administer and control departmental and agency activities effectively and to provide assurances that allow their superiors, ministers, and the central agencies to hold them fairly to account.

4.20 In essence, the central agencies set the outer boundaries of permissible activities. For example, Treasury Board has authority to act in all matters related to general administration, financial management — including the Estimates — and personnel management, including the terms and conditions of employment. These agencies have traditionally carried out their control of government operations primarily by issuing regulations, providing policy direction and guidance and authorizing spending plans based on departmental submissions.

Impact of Public Service Reform on Control

4.21 PS 2000 calls for major changes to the traditional basis of control.

4.22 Its proposals to reform the financial management system could have a significant effect on how Parliament approves the government's spending plans. For instance, introducing multi–year appropriations would require departmental plans to be reviewed on a cyclical basis instead of annually. Also, the proposals call for increasing the dollar amounts for which separate votes are required, thereby reducing the overall number of votes Parliament is asked to approve. For example, the proposed increase from $5 million to $250 million for capital expenditure votes would reduce the number of these votes to be approved by Parliament from 24 to three.

4.23 With these changes, the government would have greater flexibility to manage within its budget. Along with this increased flexibility would come the obligation to demonstrate results achieved.

4.24 The central agencies are reducing central direction to minimum basic rules. Financial and administrative policies are being simplified and reduced in number. Delegated authority in spending and contracting is being increased. Red–tape requirements for departmental spending submissions to Treasury Board have been significantly reduced and unnecessary central reporting requirements are being eliminated. At issue is what monitoring and essential controls by the central agencies should be maintained.

4.25 Similarly, departmental and agency headquarters are expected to reduce central rules and processes to a minimum, and to delegate the maximum authority possible to the field levels.

4.26 The traditional mindset of many public servants has been to design central rules and regulations that standardize administrative actions across the whole range of government activity. The reforms under way are intended to change this and to allow managers and front–line employees, at the point of contact with the public or in operations, more flexibility in responding to local circumstances. As a result, public servants at the field level are to be given much greater authority, which will extend the boundaries within which they can decide the best way to get the job done.

4.27 Central and departmental rules and processes are to be reduced and replaced by accountability based more on results achieved than simply on adherence to process. Public servants from the field level through to deputy ministers are to be more clearly accountable for their performance in managing public resources — thereby providing a better basis for ministers' accounting to the House of Commons.

4.28 Along with greater authority, however, control responsibilities are delegated to the field as well. Field managers and staff will now be responsible for better control over the operations and resources entrusted to them. The design and extent of control measures will need to be responsive to the particular risks and exposures in each circumstance. Taxpayers' money must still be managed with probity and due care, and high–quality service must be delivered.

The timing, nature and location of controls could change, but the importance and need for control continues.

4.29 The timing, nature and location of controls could change, but the importance and need for control continues. Also, control needs to be an integral part of operations rather than after the fact, and be part of the accountability process rather than an administrative add–on.

Challenges in Implementing the Reforms

Change must be managed safely

4.30 PS 2000 is an ambitious undertaking. It involves changing not only policies, systems and controls but attitudes and values as well. It emphasizes the need to eliminate unnecessary controls and to delegate authority to lower levels. However, this devolution of authority and the empowerment of front–line managers and employees must be accompanied by the development of relevant performance measures for decision making and accountability. Otherwise, it would mean a loss in control over the government's operations.

4.31 Our audits each year continue to point out lapses in control. Many of these breakdowns indicate the need for greater acceptance of responsibility for control. For example, in this year's Report we comment on:

- inconsistency in controls and lack of accountability for termination payments made to public servants (Chapter 7);
- inadequacies in information provided to Parliament on the cost of Canada's loan guarantees (Chapter 13);
- inaction to plug tax loopholes that were identified years ago, and that are resulting in substantial losses in tax revenue (Chapter 2); and
- inadequate controls over eligibility requirements for Canada Pension Plan benefits, which have resulted in annual overpayments of at least $65 million (Chapter 2).

4.32 Unless the transition is well managed, control breakdowns can be expected to increase. Thus, the government faces a significant challenge in achieving control processes that establish a sound foundation for preserving parliamentary control, while safely guiding public servants who are being asked to innovate, to take greater risks and to be more accountable. And this has to be done with existing resources.

4.33 Of concern is the fact that no clear direction has been provided on how the transition from excessive controls to greater accountability should be managed.

4.34 Moreover, the past thirty years have seen several attempts at introducing managerial controls based on setting goals and objectives and on measuring and reporting results. These initiatives did not deliver all that they were intended to. And so far, little has been said to indicate how the new initiatives will overcome past difficulties in implementing accountability measures based on results.

The government needs to deal with the negative perception of control

4.35 Many public servants view control in a negative way. They see control only as the myriad of rules and regulations imposed from above that interfere with doing their jobs effectively. Over the years, central agencies or departmental headquarters often responded to events that were potentially embarrassing to the government with detailed and restrictive requirements, meant to curtail any reoccurrences.

4.36 Over time, however, an onerous, rule–oriented administrative regime was placing a burden on public servants to feed the system, which inhibited their creativity and innovation in carrying out their jobs. Rules were followed often at the expense of taking advantage of opportunities to provide the public with better service, or of doing the job in a more effective way.

4.37 In our view, where such controls had costs — both in dollars and in their negative impact on operations — that outweighed any potential benefits, the problem was not the concept of control but the inappropriate application of control.

4.38 It is important that there be a common understanding about the nature, purpose and importance of control in the new environment — and that this view of control be a positive one.

Parliamentarians' questions need to be addressed

4.39 During the past year, standing committees of both the Senate and House of Commons held meetings on matters related to PS 2000, during which Members of Parliament raised many issues about its implementation. They are summarized in Exhibit 4.2. The two main concerns were:

- As government eliminates unnecessary controls, what assurance is there that measures will be in place to protect parliamentary control and the needed accountability to Parliament?
- How will public servants be helped to achieve high standards of service to the public, while maintaining probity, due regard to value for money and compliance with legislative authorities?

4.40 Parliament must understand, and agree with, changes in the framework and the government's assurances about it, and be satisfied that parliamentary control will not erode.

Current government studies could affect control

4.41 During the time of our review, the government announced two initiatives to examine government operations. One is a review of the efficiency of five central agencies. The other is designed to simplify the structure of

It is important that there be a common understanding about the nature, purpose and importance of control in the new environment.

Exhibit 4.2

What Parliamentarians Said

The House of Commons Standing Committee on Public Accounts (PAC) in May 1992 examined the problem of reconciling innovative management practices with parliamentary control, and how PS 2000 was progressing as a means of improving the performance of the public service. In a series of meetings on PS 2000 that culminated the same month, the Senate Standing Committee on National Finance also raised concerns related to control and guidance to public servants.

PS 2000 and parliamentary control. In noting that the task was to reconcile accountability, parliamentary controls and innovation, the PAC Chairman summed up the central issues:

"This reform is both important and desirable. The time has come to stimulate a public service that is both demoralized and subject to the constraints of a stringent set of regulations that limit innovation.

This reform should therefore make it possible for public employees to improve and increase their services by means of innovative and creative changes. In the current climate of budgetary constraint, this may be the only means governments have of maintaining the current level of service provided to Canadians.

There is a problem, however. Public Service 2000 fails to provide an accountability system for public employees and does not indicate how Parliament and Members of Parliament would exercise control over public employees' innovative ideas on behalf of Canadians. In fact, the two major elements still lacking in Public Service 2000 are an efficient accountability system and parliamentary control mechanisms."

PS 2000 and the public service. The concerns of the two parliamentary committees included the following issues in the empowerment process:

- With fewer rules, who judges whether a public servant's action is good or bad program delivery vs. being right or wrong against a rule book?
- How committed are public servants to making PS 2000 work? How will they know how far they can go with innovative solutions?
- What is the accountability of deputy ministers for carrying out the aims of PS 2000, and is PS 2000 making the intended difference? Does government have a plan to measure the effect of the change effort?
- Are empowerment pilots with best–practices learning preferable to broad–front "cultural change"? How would the change process vary from department to department?
- How sound is the implementation process for PS 2000?

government in order to reduce the number of departments and agencies.

4.42 The reviews could result in a significant consolidation of government operations and a change in the role of central agencies, resulting in further workforce adjustments and economy and efficiency measures. This would make the need for an empowered public service all the more important. But, at the same time, it would heighten the challenge to public servants to implement reforms in an environment of even greater fiscal restraint — and to stay in control.

Government Action Required

4.43 The very nature and basis of control in the Public Service is changing. No one has all the answers on how this change should take place. "Letting go" to transfer decision ownership to subordinates is perhaps difficult for many, given the history of management in government, and manager education in accepting risk cannot be achieved overnight. The many processes of change will have to be fitted together and managed coherently.

4.44 The government has taken important steps to implement reform in a number of areas — human resource development; the introduction of "shared management agendas" between the Treasury Board Secretariat and heads of departments and agencies; the delegation of administrative authorities; the introduction of new departmental operating budgets; and the development of mission statements and standards of service to the public that can be used to hold departments and agencies accountable for results. The government has also begun to examine the implications that reform will have for the control framework. And new guidance is being developed in the areas of financial management, information management and contracting.

4.45 A committee of assistant deputy ministers drawn from central agencies and line departments was formed in the fall of 1991 to examine how to change the control framework to foster the aims of PS 2000. At a meeting of the Public Accounts Committee (PAC) in May 1992, the Secretary of the Treasury Board said the assistant deputy ministers' committee would be examining the implications of reform for parliamentary control, the concept of cyclical program reviews, the form and content of the Estimates and other information provided to Parliament, the meaning and nature of control and the development of service standards.

4.46 The Secretary added that he hoped he would be in a position to return to the PAC in the fall of 1992 with some concrete ideas. This commitment is encouraging.

The change process should be carefully managed

4.47 As the government proceeds with its reforms, there are a number of things we think it should do to ensure a safe transition. These are set out below. Managers we met with also provided useful insight on the issues and on what needs to be done. Some of their specific comments are reflected in Exhibit 4.3.

4.48 Attention should be paid to important aspects of the change process; in particular, the following:

- confirming overall responsibility and accountability for the process;
- developing a plan, with stated objectives and timetables;
- establishing what controls are essential in managing in the new environment;
- identifying what the control mechanisms should be at each of the various levels of government;
- involving in the control–setting process the public servants, central agencies, and others who will be bound by the new standards;

- establishing mechanisms for monitoring the progress of the devolution; and

- reporting results regularly to interested parties.

4.49 It is important that the government make parliamentarians fully aware of the substantial impact that reform could have on existing parliamentary control. They will also need assurance that this framework, while encouraging greater effectiveness and efficiency through innovation by public servants, will respect the principles of parliamentary control.

4.50 In our view, the roles of central agencies in reformed management should be better identified and communicated. The central agencies need to sort out among themselves their respective roles and responsibilities for control and accountability. The nature and the degree of monitoring, enforcing, advice and policy guidance need to be determined and communicated to departments and agencies and to Parliament.

4.51 Visible, strong and committed leadership has to be maintained throughout the transformation.

The concept of control needs to be broadened

4.52 In an empowered public service, more emphasis will be placed on results than on prescribed processes. The concept of control in government needs to be broadened from restriction and prescription to the idea of bringing about achievement while protecting against unwanted events.

4.53 It is also important that managers and their staffs be educated on the importance of control and modern management control practices. When combined with contemporary management, good administration and intelligent interpretation, control leads to efficient and effective operations.

4.54 For example, control self–assessment techniques are gaining recognition in the private sector. They encourage managers and their employees, through workshops or other forums, to regularly examine their business objectives and the adequacy and relevance of controls. This practice is thought to have several benefits, including improved understanding of

Exhibit 4.3

What Managers Said

About Control

Parliament's most powerful function in authorizing expenditures would seem to be to establish what is to be accomplished by the funding. If MPs want to be empowered they should get reporting on the achievement and not just annualized information about inputs. And if it's all just rubber stamping, why go through the process?

There's nothing wrong with control; what's wrong is the number of controls.

Control is perceived as "stop doing", not "start doing". The balance should switch to the "achieving" side of control.

There are inconsistent messages in delegation of authority. It gives freedom and then takes it away. Suddenly there are more restrictions like "Don't travel or use the hotels in the green pages of the directory".

PS 2000 hasn't addressed headquarters and regional responsibilities and who is accountable for what. There's still a tendency to withhold decision-making power from the regions.

Empowerment produces control because employees become more responsible.

About Accountability

There have to be controls but accountability is diffused. You can't talk about control without talking about accountability. Yet accountability has been a separate exercise, confined to having followed rules. With PS 2000 you have to put them back together.

PS 2000 doesn't deal with mistakes. What do you do with someone who does something out of line? We need clarity on what represents an error to ministers, senior managers and central agencies and what will happen when errors are made.

Shared responsibility and accountability is increasingly a problem in achieving results; we're going to have to find a way to deal with this as things like the Green Plan make it more and more a significant issue.

If you're going to do justice to the responsibility–accountability link, you have to educate not only the managers but also the media and MPs to make managers more comfortable in taking on more responsibility. They are ill–equipped and some are leery of taking on more responsibility and accountability.

We feed up but get no feedback down. People should see control and accountability as being interactive.

About Risk Taking

Delegation to departments by central agencies puts pressure on central headquarters. They are worried about fouling up so they create new rule books. We have to let functional managers make some mistakes too.

The basis of empowering is trust. You have to allow risk before everything is in place. We have got to err on the side of risk taking, and support it.

We need to work on risk management. Training resources have to go behind all the nice talk.

About Reward Systems

Achievement standards aren't the standards we're judged by. So we've not been putting the long–term payoffs in submissions and just word them for acceptance. Then we don't get substantive challenge; only nit–picking.

The whole control system is disconnected since resources are not tied to performance. And the reward system seems only to expect further cuts from the manager who successfully cut budgets before.

business operations and key controls, stronger acceptance of the value and importance of control, and improved problem solving. The use of these techniques in the federal public service should have the same benefits.

The concept of control in government needs to be broadened from restriction and prescription to the idea of bringing about achievement while protecting against unwanted events.

Fundamental rules are needed that constitute the decision boundaries for public servants

4.55 A main element of control in an empowered management culture is a set of fundamental rules. These rules reflect the organization's beliefs, values, management principles and code of conduct and, based on an analysis of business risk, they establish boundaries within which employees can make decisions.

4.56 Fundamental rules do two things. They minimize risk to the organization, and they encourage reasonable risk taking and innovation by giving employees greater certainty about what they can do.

Exhibit 4.4

An Example of Fundamental Rules for Risk Management in a Canadian Corporation

Fundamental Rules

	Rules
Ethics	Don't do anything illegal or unethical – Follow Business Conduct Guidelines
Controls	Risk acceptances must be documented
	Keep to delegated authority for: – Financial signing levels – Pricing, discount and uplift levels – Personnel and compensation – Hiring – Hiring and use of consultants
	Keep to generally accepted accounting principles
	Maintain adequate controls: – In the business process and ensure that change can be administered – Over assets, income and tax obligations
	Only write contractual commitments with Legal or Business Offerings guidance
	Don't create a substantive precedent – One that obligates IBM to make a similar decision outside your trading area
	Follow process for: – Release or acceptance of confidential information – Release of unannounced product for technical info. – Acquisition of non–IBM hardware for resale/lease – Acquisition of non–IBM software
Corporate Policies	Don't make political contributions Be fair to customers, suppliers & business associates Involve Industry Relations in contacts with competitors (other than normal sales or purchasing situations) Do not adversely affect the environment Comply with IBM design standards

Dealing with Differences

Whenever differences result in an impasse, it is up to the dissenting party to decide whether to carry the issue further.

- If a change to a guidelines is being proposed, then it's up to the initiating function to inform relevent IBM departments so they have an opportunity to give advice
- Where there are differences between departments, provided a fundamental rule is not involved, it is up to the dissenting department to decide whether to escalate
- If a change to a fundamental rule is proposed, the originating area cannot proceed without the approval of the owner of that rule

Think . . .
Is it right for the customer?
Is it right to IBM?
Is it ethical?
Is it consistent with our basic beliefs?

Remember . . .
'It's Your Business'

- For questions on the risk Management process, call Business-Offerings or Controls Evaluation.

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4.57 The rules are few but firm, and breaking them results in sanctions. For instance, a rule in any organization is "Don't do anything illegal". An example of the fundamental rules in a major private sector organization is shown in Exhibit 4.4. These rules are based on that company's core values of respect for the individual, best customer service, and excellence in execution. They also reflect the risks the company wants to avoid in running its operations.

4.58 The federal government lacks an equivalent set of rules. We think they are a key element of empowerment. Public servants must be able to reconcile the rules that respect Parliament's control with innovative action that they feel will produce better results. And, equally, Members of Parliament must be assured that the principles of parliamentary control are being respected.

4.59 All levels of management, in consultation with ministers and other Members of Parliament, should be involved in developing these rules. Managers and their staffs need to understand and agree to them. Exhibit 4.5 provides examples of what fundamental rules in government might look like.

Public servants need to build skills in risk management that will allow them to make decisions and accept risk, while keeping that risk within agreed limits

4.60 Managing risk is knowing the chances of encountering harm or loss and knowing its probable severity, and taking decisions that allow for that risk but keep it within agreed limits. It involves a formalized process of risk assessment, measurement and control. As public servants begin to assume more risk, tolerance zones need to be made clear to them. It requires trust, at all levels, in public servants' competence, and forbearance when things go wrong in the learning. Patience will also be required of ministers and other Members of Parliament.

4.61 Public servants need simple but sound methods to identify acceptable risks through disciplined assessment of consequences and probabilities. They need understood structures and processes for taking extraordinary but authorized action. In our view, risk management is a key element in reshaping the government's control and accountability framework and should be a high priority for employee training.

Accountability for results, from the front–line employee up to Parliament, has to be fair and visible

4.62 Accountability, the obligation to answer for the discharge of one's responsibilities, is basic to democratic government and an integral part of an effective control framework. The issue in empowerment is not so much delegation of power and spending authority as agreeing on what public servants are to be accountable for, and to whom. It is important that well–understood accountability processes be in place.

4.63 Such processes need to have:

- clear and visible objectives and standards of service against which performance of the organization can be measured;
- relevant indicators of performance to assess results achieved, with emphasis on usefulness rather than on precision of measurement;
- reliable and accessible information systems to support decision making and measurement of results; and
- timely and understandable reporting on results, on the quality of control systems for program achievement and on compliance with legislative authorities and fundamental rules.

4.64 These accountability processes provide a specific basis for government's reporting that would give parliamentarians sound information.

4.65 Chapter 6 on Information to Parliament proposes a set of principles and a framework for departmental reporting to Parliament. It assesses existing reporting against these, and makes a number of recommendations for improvement.

Good information is essential for control

4.66 Public servants at all levels must have access to and be able to rely on good information if they are to meet agreed service standards and to be held accountable. Program achievement and the ability to hold individuals accountable for it depend on the quality of available information. Therefore, managers have the responsibility to manage information and technologies in ways that produce the needed information. This means that they:

- know what information is needed and available;
- have standards for information quality in place; and

The issue in empowerment is not so much delegation of power and spending authority as agreeing on what public servants are to be accountable for, and to whom.

Exhibit 4.5

Some Examples of "Fundamental Rules" for the Federal Public Service

These are examples of possible "few but firm" rules. They are not intended to be comprehensive.

- Do nothing illegal. Uphold the spirit and letter of laws and regulations.
- Act within your delegated authority.
- Act in a politically neutral manner.
- Act impartially, honestly and fairly.
- Don't waste public money.
- Safeguard assets.
- Respect the core values of your organization.
- Make service standards visible.
- Realize the productive potential of all resources entrusted, especially people.
- Don't make decisions that commit significant public resources without proper authority.
- Document risk acceptance.
- Account for the discharge of responsibilities and achievement of agreed performance.
- Get authority for waiving a fundamental rule.

- have the capability to identify, evaluate and manage their information resources.

4.67 The rapid advances in information technology, including systems networking and on–line input and retrieval of data, provide greater opportunities for front–line public servants to get direct access to the information they need to manage. This also has the potential for significant change in culture and in the way business is done. These changes in technology and organizational structures mean that control processes will also change.

Modern management concepts are increasingly being introduced in departments and agencies.

Internal audit and program evaluation can play a key role

4.68 Both internal audit and program evaluation are an important part of the process in assessing the effectiveness of control. Both functions are subjects of government–wide audits scheduled for reporting in 1993.

4.69 In an empowered public service, it is likely that the focus and nature of work in these areas will change. For instance, our office recently published a survey of internal audit practices in some 40 private sector companies and government departments. In those organizations that have undergone changes in management culture, there has been a shift to more pro–active, preventive auditing rather than after–the–fact "detective" auditing. Greater emphasis is being placed on the use of technology, earlier audit involvement at the design and implementation stages of systems and programs, and risk analysis.

The right reward system is needed

4.70 Effective reward systems are key to ensuring the desired change to an empowered public service and to producing agreed levels of service. The systems need to motivate public servants to raise service standards, protect parliamentary control and account fairly for their performance.

4.71 When rewards are to be based on reported results rather than on compliance with process, new issues arise. For instance, how are public servants motivated to report honestly and fairly, and what are the safeguards against performance being overstated? What are the reporting standards that government should propose? And how are public servants to be involved in setting the performance and reporting standards?

Learn from pilot projects and other experience, and apply the learning

4.72 The length, quality and nature of the change process will vary from organization to organization. In an environment where control systems are being radically changed and individuals are being empowered to a degree that they never have been, it is important that the results of the change process be monitored and evaluated on a timely basis.

4.73 Implementing change incrementally through the use of pilot projects and other experiments minimizes risk. This approach means choosing the most promising organizational units to implement the change and pushing risk taking to the limit, while controlling it. Learning is then captured from the experience and used by others — including how to deal with unintended outcomes.

4.74 Modern management concepts are increasingly being introduced in departments and agencies. Common features include statements of mission, values and strategic objectives, together with the leadership, managers' freedom in making decisions and the learning needed to bring about the organization's intended achievement. Exhibit 4.6 gives one example, Correctional Service Canada.

Conclusion

4.75 Sustained leadership at all levels of government is needed to carry through the transformation in public service management. Government needs to show Parliament that it is transforming management of the public service at a successful pace, and that it is dealing with important control and accountability issues.

4.76 To make this happen, there are a number of important steps that the government needs to take — urgently — to ensure safe transition to an empowered public service.

- Sort out the overall responsibilities for achieving the control process that will meet the needs of an empowered public service, and establish an implementation plan that sets out objectives, time frames, and who is responsible and accountable for maintaining control.
- Identify and clarify the roles of central agencies in the control framework.
- Educate managers in contemporary management control techniques and in broadening the concept of control. This is particularly important in view of the negative perception of control held by many public servants.
- Establish fundamental rules that constitute the decision boundaries for public servants and involve them in setting these rules. Such rules should be based on ethics and values in the public service and should respect the principles of parliamentary control.
- Build up public servants' skills in risk management that will allow them to make decisions and accept risk, while keeping that risk within agreed limits.
- Ensure that there is fair and visible accountability for results, from the front–line employees up to Parliament. This means having in place clear objectives, agreed standards of service, relevant performance measures, reliable information systems and timely and understandable reporting systems.
- Motivate public servants to accept responsibility for raising standards and controlling, and accounting fully for, performance.
- Maintain visible, strong and committed leadership to see the process through.
- Report to Parliament regularly on the critical success factors in the devolution of authority and responsibility, including the development of the new control framework.

4.77 Parliament should call for assurance that the needed action steps are being taken.

There are a number of important steps that the government needs to take — urgently — to ensure safe transition to an empowered public service.

Exhibit 4.6

Getting it all together – Correctional Service Canada. In 1988 the Service undertook an organization–wide process to define its purpose. Led by the Commissioner, managers forged the Service mission statement that set the future direction and boundaries of what was to be achieved. The Commissioner took the Minister through their direction–setting process and received the Minister's support. Each successive minister has given his.

In support of the mission statement, the Service adopted five core values, a set of guiding principles and specific corporate objectives. Through sustained leadership of the Commissioner and his executive, managers undertook to adopt these core values in their work and promote them with front–line employees.

Decision-making authority was increasingly delegated. In so doing, managers agreed that in most operating matters the quality of decisions made in Ottawa would not be higher than those made by the front–line managers. People were trusted to produce provided they were given the necessary support to achieve self–control. Accordingly, the Service introduced accountability contracts, performance standards and measurement, procedures for self–assessment, increased training of employees, and information systems for measuring performance and spending that are openly available to managers for comparison with targets and with other organizational units.

The Service now believes it has:

- stronger overall control, higher morale among managers and better relations with central agencies.
- improved program delivery by adopting new ways of doing business, such as "unit management" where key operating functions are to be integrated, including security, case management, health and safety, rehabilitation programs, and resource utilization.
- increased the importance of risk assessment of offenders when they enter institutions so that costly incarceration and lengthy rehabilitation may be safely minimized.
- been better able to deal with reduced levels of management and budgets.

In 1992 the Commissioner describes the Service as "value based but results driven". The Service also recognizes that the transition is not complete. In particular, strategic objectives are to be reassessed, performance standards and measures are to be further developed, and accessibility to corporate information is to be increased.

***Government response:** The federal government has in place a financial control framework designed to ensure that public funds are spent for the purposes approved by Parliament. The objectives of this framework will not change as a result of Public Service 2000.*

Public Service 2000 is the government's plan to foster a client-centred and results–focussed Public Service, better equipped to reduce the cost of delivering programs while at the same time continuing to provide the Canadian public with high-quality service. It is, first and foremost, a change in attitudes and the culture of the Public Service, and this has already begun.

Over the years a large body of detailed and prescriptive rules and procedures have been developed by central agencies and departments. The Auditor General has pointed out that these often cost more to implement than any benefits they might reasonably produce. Experience has shown that detailed rules and procedures did not provide greater assurance of probity and prudence, and furthermore, tended to stifle innovation and divert attention away from serving the Canadian public.

The government recognizes that, as reforms under Public Service 2000 proceed, the current control framework will have to be adjusted. Unnecessary and outdated rules continue to be modernized or eliminated entirely. Prescriptive and lengthy procedures are being replaced by policy guidelines written for the operating manager, not just for specialists. They will shift the focus from process to resources, results and outputs. Increased emphasis will be placed on accountability. Essential controls will remain in place and will, indeed, be clearer and more visible to those accountable for program delivery.

Public Service 2000 will not jeopardize Parliamentary control, nor the overriding principle of ministerial accountability.

Chapter 5

The Learning Organization

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The Learning Organization

Deputy Auditor General: Larry Meyers
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Main Points

5.1 Today's organizations operate in a world of rapid and accelerating change. To stay relevant, effective and competitive, these organizations must learn at least as fast as their environment changes. This means maintaining a fit between the organizations' assumptions about reality and reality itself.

5.2 The learning organization views change not as a threat to be resisted, but as an opportunity to become more confident, responsive and effective.

5.3 The learning organization encourages its members at all levels to learn continually and to embed their skills and knowledge into its attitudes and practices.

5.4 Organizational learning is inspired by "learning champions." These are people who foster a sense of purpose, develop enlightened strategies, attract other committed people, and view work environments as continual learning structures through which service and performance can be improved.

5.5 The learning organization sees itself as part of an interactive partnership with its customers. This relationship involves a process of ongoing development through reciprocal feedback. Together, the partners create products and services that are valued by society.

5.6 The public service could foster organizational learning through experimental projects in a variety of areas. These projects would emphasize continuous learning as the basis for effective teamwork and for improvements in service and performance. Learning and innovation would gradually become dominant characteristics of the public service culture.

Introduction

5.7 This chapter reports on a study of organizational learning in a public service environment. The study began with the question "How does an organization learn to perform well?" As we proceeded, we realized that learning to perform well was not the fundamental question. After all, some organizations perform well because of inspired leadership, or because they are in the right place at the right time. Once these factors disappear, performance deteriorates and the organization may even fail.

5.8 The question then became "How can an organization learn not only to perform well, but also to sustain performance and become truly innovative?" The answer, we discovered, is that it must become a "learning organization".

5.9 This study draws on field work we did in four government departments: Statistics Canada; the Administrative Policy Branch of Treasury Board Secretariat; the Canadian Centre for Mineral and Energy Technology in Energy, Mines and Resources Canada; and the Goods and Services Tax project in National Revenue – Customs and Excise. While we do not describe these organizations in detail (see Exhibit 5.2), we illustrate our points throughout the text with comments from their managers.

5.10 We also use insights gained from several private sector corporations, from a number of researchers active in this field, from our board of advisors and from our review of the literature.

5.11 Much of the literature on organizational learning focusses on industry, where the driving force is fierce competition. Our study focusses on organizational learning in a public service environment.

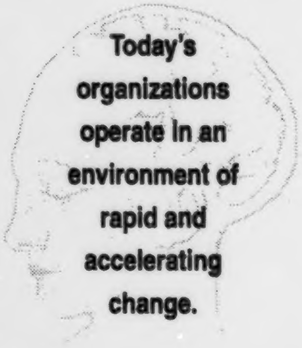
5.12 We discuss the learning organization under four headings:

- Why is organizational learning important?
- What is organizational learning?
- Three perspectives on organizational learning
- Suggestions for the public service

Why Is Organizational Learning Important?

Coping with rapid and accelerating change

5.13 Today's organizations operate in an environment of rapid and accelerating change. In the private sector, this environment includes new customer demands and intense competition. In the public sector, it includes growing public expectations, increasing demands for individualized service, expanding workloads and continued resource constraints. In both sectors, technological breakthroughs create additional pressures. Many of today's jobs didn't exist five years ago — and may not exist five years hence.



Today's organizations operate in an environment of rapid and accelerating change.

5.14 In a relatively stable environment, once an organization has learned how to operate well, the need for further learning is diminished. However, the swift pace of today's world demands

Exhibit 5.1

Earlier Studies in This Series

Over the past decade, this Office has published several studies that explore how organizations can improve and sustain their performance. The first study addressed the question: Why do serious managerial weaknesses persist, in spite of conscientious efforts to overcome them? We found that managers were constrained by political priorities, by too many administrative rules and regulations, and by systemic disincentives. We published the study under the title *Constraints to Productive Management* in 1983. Our Report pointed out, however, that some organizations do work well, in spite of these constraints.

Our next project identified the attributes characteristic of such well–performing organizations. We documented twelve attributes, grouped in four clusters: emphasis on people; participative leadership; innovative work styles; and strong customer orientation. We published that study in 1988 as *Attributes of Well–Performing Organizations*.

While the 1988 study explored the competencies and skills of organizations, it said nothing about the affective side of organizational behaviour. We therefore designed our next project to address the impact of values, attitudes and motivation on organizational performance. We published the results in 1990 as *Values, Service and Performance*.

These studies have had widespread acceptance, both in Canada and abroad.

that an organization develop a dynamic learning culture.

Organizations must learn at least as fast as their environment changes.

5.15 To stay relevant and effective, in fact, organizations must learn at least as fast as their environment changes. To be innovative, they must learn even faster — they must anticipate the future.

What Is Organizational Learning?

Learning is more than adapting

5.16 Many organizations deal with change by simply adapting. While adaptation is an element of learning, it is mainly a reactive function. Like chameleons and amoebas, organizations that merely adapt wait for circumstances and situations to dictate a course of action. But this is a limited type of learning. At an advanced level, the learning process is much more deliberate, reflective and anticipative.

5.17 The distinction between an adaptive and a learning organization is subtle, yet profound. Both organizations operate in the present. However, the adaptive organization is slightly behind; it is just arriving from the past. The learning organization is

Exhibit 5.2

Background on Departments

ADMINISTRATIVE POLICY BRANCH

The Administrative Policy Branch of Treasury Board (APB) was created in the 1960s to emphasize prudence and probity in government. The organization has now adopted a philosophy of partnership with its clients. APB has assumed what some managers have termed more of a "leadership" rather than a "directing" role.

The work of the Branch has changed to meet its new mission. There is a new emphasis on innovation, and on taking the initiative to create new opportunities. There is also receptivity to the idea of responsible risk–taking. APB's new focus is on partnership with its clients rather than simply on managing crises and issuing directives.

CANMET

In 1987, the Canadian Centre for Mineral and Energy Technology (CANMET) realized that although the scientific quality of its work was high, its delivery and the associated transfer of technology were not meeting clients' changing needs. It also felt the pressure of government funding restraints.

CANMET concluded that it had to become more client–oriented and find ways to increase the revenues of the organization. Now when research is undertaken, the client is involved from the outset and often shares project costs. This development has required continuous learning of how to plan and manage work in partnership with clients.

GST

In February 1989, the Goods and Services Tax (GST) was announced in the Finance Minister's budget. Shortly afterward, the Department of National Revenue – Customs and Excise began developing the collection and administrative system for the GST. The deadline for "switching on" the tax was January 1991. The Department, which had traditionally been an enforcement and collection agency was now faced with designing and implementing a very complex new system under severe time limits. This meant that the Department had to undergo a period of rapid learning during which it would be asked to change its thinking, practices and culture.

One of the most important lessons the Branch learned was the capacity to identify the two or three most crucial tasks that needed to be done and to stick to them. This was matched by a readiness to work well together and to use knowledge and expertise from many sources in order for the project to proceed. The Branch also learned that agreeing on goals, committing to them, and allowing employees the freedom and ressources to develop and design their own action plans was crucial for success.

STATISTICS CANADA

Fifteen years ago, there was considerable media criticism of the agency. Today, some international journals describe it as the best statistical agency in the world.

The agency's planning process, for example, is now a vehicle for organizational learning. It is a means of creating horizontal communication and corporate awareness among managers who rarely interacted previously. Built into the system is a "what if" approach that emphasizes forward thinking, requiring managers to identify "contingencies" and "efficiencies". The process has allowed the agency to be more responsive to its environment, thereby enabling it to have a greater influence. The agency also promotes learning by deliberately rotating managers with a view toward developing the next generation of senior leaders as well as fostering a corporate orientation. These efforts have contributed to cross–pollination of ideas and experiences throughout what was once a very vertical organization.

slightly ahead; it is just leaving for the future.

Organizational learning differs from individual learning

5.18 Learning is a natural function of all living beings. Unfortunately, the desire to learn can be stifled through discouragement or fear, or it can turn into complacency through lack of incentive. However, the desire to learn can be re–awakened. We reported this in an earlier study in this series (see Exhibit 5.1). We said that people have three basic work–related aspirations: They want to do a decent job; they want to be appreciated; and they want to be proud of their organization. The underlying drive is the desire for mastery and self–fulfilment.

5.19 When individuals serve customers, collaborate with colleagues or try to solve problems, they learn new skills and acquire new knowledge. This becomes organizational learning when their skills and knowledge are embedded in the attitudes and practices of the organization (see Exhibit 5.3). This is one of the core processes of organizational learning.

Three Perspectives on Organizational Learning

Characteristics of Organizational Learning

Learning is an ongoing process

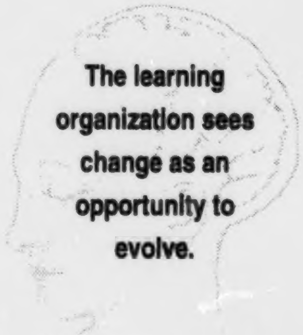
5.20 An organization typically starts out flexible, dynamic and innovative. There are few barriers, and communication flows easily. The young organization is responsive to its environment and learns new practices continually.

5.21 Over time, however, an organization develops a strong culture, and its practices tend to become static. If this happens, the organization becomes self–absorbed and stops interacting with its environment. It no longer reviews and challenges basic assumptions, even though the world outside is continually evolving. Such an organization will not survive in a changing world.

5.22 The learning organization sees change as an opportunity to evolve. It is both proactive and responsive to its milieu. It can live with and produce change. One manager in our study noted, **"If you're adaptable, you can cope. If you're not, you can't. We are creating a culture of continuous organizational learning as a means of preparing ourselves for the future."**

5.23 As part of its evolution, the learning organization is also able to "unlearn" or discard obsolete practices. This process is often difficult because it means uprooting outdated assumptions and values that have become ingrained in the organizational culture.

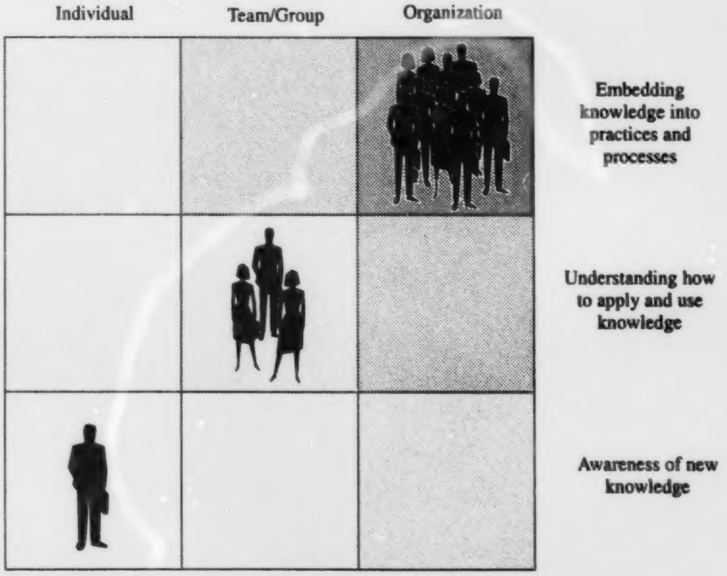
5.24 Even when people are willing to change, the process of unlearning and adjusting can be demanding and unsettling.

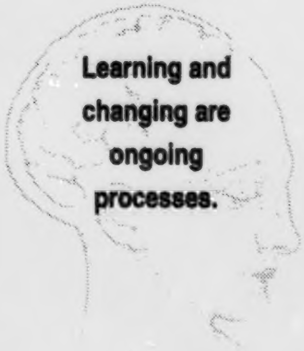


The learning organization sees change as an opportunity to evolve.

Exhibit 5.3

Progression in Learning


Individual
Team/Group
Organization
Embedding knowledge into practices and processes
Understanding how to apply and use knowledge
Awareness of new knowledge



Learning and changing are ongoing processes.

"The skills required for the old work were very different than those required now....You can do three things in this situation: reassign people, train them, or change them through attrition, appointment, or removal....We had to bring in new blood and do new functions. We did job enrichment and enlargement. Some people retired, others left because they were uncomfortable with the new approach, and others adapted to the new environment....Never underestimate people's capacity to change."

5.25 Traditional management–of–change programs treat learning and changing as a project with a specific beginning and end. Such a project involves unfreezing the status quo, introducing a new one, and then freezing that new status quo. This project is typically designed by outsiders and then "implemented" within the organization. The underlying aim is the transformation of the organization from one stable state to another.

5.26 This approach is reactive and limited because it is often only a way of catching up with a changing environment. Yet, when the organization gets there, "there" may be gone because the environment has changed again. As a result, the organization tends to be out of sync with reality.

5.27 The learning organization views learning and changing as an ongoing process, a continuum with no specific beginning or end. It focusses more on the future than on the past. Instead of reacting to pressures, it seeks out emerging trends and anticipates conditions that are likely to occur in the future (see Exhibit 5.4).

Learning through experimentation

5.28 Experts in most fields have developed strategies for "trying things out" so that they don't have to live with the consequences if the results are unsuccessful or catastrophic. Hydraulic engineers build flow models of dams and canals to learn how best to design and construct real ones. Aeronautical engineers test models of new aircraft in wind tunnels before starting commercial production. Software engineers do exhaustive product testing before putting their packages on the market.

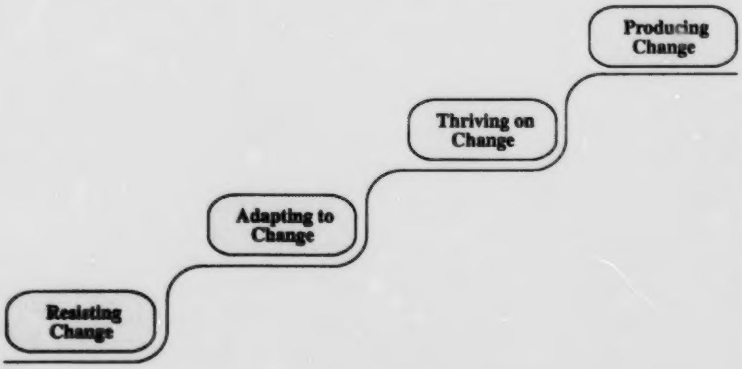
5.29 Managers, especially in traditional bureaucracies, seem to be alone in having no generally accepted strategies for modelling and testing their ideas before putting them into practice. The accepted custom is to move from theory to full–scale implementation.

5.30 In the learning organization, managers gain experience without having to fear the consequences of their actions. They do this through scenarios, pilot projects or simulations.

5.31 In the scenario approach, various possible situations are discussed, developed and documented. Participants play out "What will happen if we do X?" or "What will we do if Y happens?" scenarios. This allows managers to explore consequences in a playful mode, and to understand the various interrelationships. The process is a tool for "learning from the future". It is also a strong catalyst for binding a team together, because participants can discuss their

Exhibit 5.4

Learning Plateaus



mental models and assumptions and work towards a common understanding.

"Built into the approach is a 'what if' approach to planning, an approach which emphasizes forward thinking. This is done by requiring managers to identify 'contingencies' and 'efficiencies'.... Probably the most useful aspect of the plan was in its preparation. The process of constructing it involved all the various managers. It forced everyone to focus on the details of what they had to do, but it also required them to identify the interdependencies. Perhaps most crucially, the process reinforced the managers' ownership of their respective tasks."

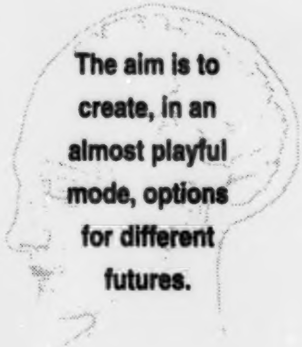
5.32 In the pilot project approach, a small group is offered the opportunity to operate under a new set of norms or assumptions. For example, a central policy group may have operated under the assumption that unless regional operations are strictly controlled, they will perform poorly. This could be replaced by the idea that regions want to perform well and should be involved in policy development. Such a project would be judged primarily on what new insights are gained as a result of this alternative mode of operation. The overall aim of the pilot project would be to learn about better ways of performing and of working together.

"If you want to be a leader in policy, you have to be open to the groups that are affected by your policies. You have to be open to all kinds of ideas and you have to know where the state of the art is. Otherwise you become inward looking and self–centred and, in the end, irrelevant. The public service deserves the best policies we can develop. So it is our responsibility to know what works best and what doesn't work. And sometimes we can only find out by trying — preferably on a small scale."

5.33 Simulation is a third approach to learning through experimentation. This approach is based on the electronic revolution that pervades our society. It allows us to act out a possible future without having to suffer the consequences. For example, pilots learn in flight simulators. It is comforting for frequent flyers to know that pilots don't learn to fly aircraft with a full load of passengers.

5.34 Managers can use the power of this technology to construct and play out scenarios that could be costly or dangerous in real life, but are inconsequential in electronic form. Designers and mathematicians use this technology as a matter of course. In sports, the use of video playback allows the coach and team to analyze plays and improve performance.

5.35 The constellations of knowledge available, along with new technologies, are creating numerous opportunities for learning. For a variety of reasons, many organizations have not yet taken full advantage of these possibilities.



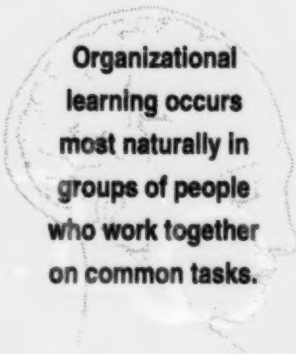
The aim is to create, in an almost playful mode, options for different futures.

Measuring progress in learning

5.36 An important aspect of organizational learning is the ability to measure its progress. In this study, we considered the possibility of researching the topic, but did not do so because of its complexity and time demands. We suggest, though, that traditional approaches tend to be inadequate for measuring the dynamic process of organizational learning.

5.37 An analogy will illustrate. An airliner uses less fuel in thin air than in dense air. It therefore climbs to high altitudes on long flights. During the climb, fuel consumption is very high, yet over the entire journey, it will be more efficient because the fuel saved at higher levels more than makes up for the cost of the climb. However, this improved performance will not become apparent until some time after the climb. An observer who measures fuel consumption only during a climb will be disappointed. If he is shortsighted, he may criticize the practice. If he is powerful, he may even forbid it.

5.38 Similarly with organizational learning. When an organization spends energy to learn and initiate change, performance may initially decline but should eventually rise above its original level. This phenomenon is well documented in manufacturing and production environments as the "learning curve". It is less well documented in service sectors. The point is that there may be a considerable time lag between initiating a specific learning process and realizing results in terms of changed performance.



Organizational learning occurs most naturally in groups of people who work together on common tasks.

5.39 Until a change in performance occurs, the gap between investing in learning and realizing the results represents a leap of faith. Because of this uncertainty, long–term improvement processes may be prematurely terminated. In contrast, projects that are failing may be pointlessly continued.

5.40 Until the organization develops appropriate methods for measuring progress in learning, managers would do well to continue measuring progress in results as a feedback mechanism for improving their practices.

Where Learning Takes Place

Learning in traditional organizations

5.41 Traditional management and learning approaches in the public service are concerned more with preventing errors than with innovation. The focus is on following the rules, avoiding risk, and observing detailed authority and control structures.

"Before, the biggest concern was you didn't have a typo in a document. It didn't matter if you were doing anything .... There's a lot more openness now to new ideas, to innovation, to trying new things, which was not the case before."

5.42 In bureaucracies, most learning that deals with change and innovation occurs at the top and is passed down the line in the form of directives, instructions and standards of compliance. At the working levels, learning is restricted to obeying directives and complying with standards.

"We were very much into a command and hierarchical type of operation. We set the rules, and the operating people were expected to follow them."

5.43 In order to minimize costs and maximize gains, designers of organizations are prescribing duties that facilitate finding and training workers. Managers are given power to direct, challenge, evaluate, reward or penalize employees. This centralization of power may help an organization to function, but it also creates anxieties and tensions that limit learning.

5.44 Yet organizational learning occurs most naturally in autonomous groups of people who work together on common tasks, especially when "learning champions" and the organizational culture encourage it. Clusters of committed workers and managers often generate a high level of collective understanding and learning — but typically only when they are free from restrictive centralized power structures.

5.45 In a fast–changing environment, traditional management approaches are no longer adequate. Managers need a larger perspective that nurtures individual growth and creativity, which in turn can benefit the entire organization.

Interaction within the organization

5.46 To achieve and maintain a fit with a changing environment, the learning organization practices a continuous and deliberate process of dialoguing with, influencing, adapting to, and shaping its environment.

"There has to be a fit between the environment and the management

process. Our planning process is adapted to our particular set of circumstances, within the organization and within the framework of the Canadian government, within the constraints and opportunities it presents, within the socio-economic context of Canada and the clients we have to serve."

5.47 A learning environment thrives on diversity. Each person contributes unique experience, culture and values to the organization. This important mix can be strengthened through the hiring process. Positions can be filled laterally, at all levels, through secondments with other departments and agencies or through internal rotational assignments. These methods allow the organization to make use of the talent and knowledge of people from a wide range of backgrounds.

5.48 However, this diversity must be integrated into a corporate philosophy that enables the organization to make coherent strategies and future–oriented decisions. With this philosophy, its members develop and sustain a common understanding, both of one another's ideas and of the external environment.

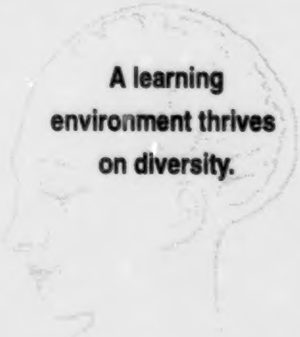
"So it's our responsibility to be on top of the literature and know where other countries are going, and where others are; what works and what doesn't; how it impacts on departments — the effects on service delivery or whether programs will work for the client."

5.49 Employees learn and exchange ideas in many ways — through individual networking, dialoguing, and sharing insights, especially within clusters of people that do similar work. Learning also takes place through formal training programs, conferences, research projects, developmental assignments, studying the literature, and attending courses. The knowledge gained is assimilated by the entire organization.

"We found that it's far better for everyone to interact and work together. It's not only easier, it's more productive, you get more payback for the Crown."

Leadership in organizational learning

5.50 While structures and systems must be aligned with learning, attitudes and practices must also change. In order for learning to succeed and flourish, one of the key elements is leadership.



A learning environment thrives on diversity.

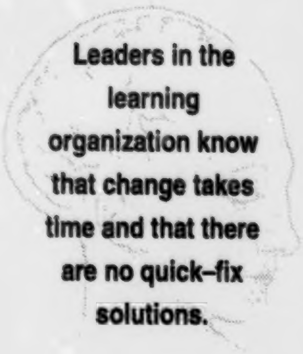
"All those things such as programs, techniques, and management approaches are a piece of it. They will only function in an organization if you have a strong belief among the leaders of that organization, and you have key leaders sprinkled throughout, that really believe in that and constantly push for it. It's like being converted to a religion. You might have all the right stuff to put together, but it will grow and continue, in a large organization, only if the chairman is 'so convinced' that he uses every occasion to promote and reinforce his message."

5.51 Learning–oriented leaders or "learning champions" will create and nourish opportunities for learning. Leaders in the learning organization have the ability and drive to seek out new information and new ideas, to listen to criticism and dissenting views, and to help establish learning teams. They ensure that communication flows freely and that the momentum for change remains alive.

"To be effective, we have to be leaders. To be leaders, we have to be up–to–date; have networks; have knowledge; have the right people. If you don't have that combination, you quickly become out of date, irrelevant, and it's a downward spiral from there... People enjoy their work a lot now, in a learning organization, and because they enjoy their work, they produce better, and because

they produce better, the organization's more effective.”

5.52 The challenge of leadership is to meet the learning needs of the organization and those of its members. Leaders in the learning organization know that learning is a continuous process, that change takes time and that there are no quick–fix solutions. They encourage experimentation and reflection. Yet, not only leaders are responsible for learning. Ideally, all members of the organization should keep abreast of new developments in their field.



Leaders in the learning organization know that change takes time and that there are no quick–fix solutions.

“Organizations learn like babies. There are long periods during which you try to make them learn new things, and there seems to be no effect and no improvement at all. And just when you are ready to give up, suddenly they have learned the new thing and are doing it. It is important to realize and remember this so that you don't give up hope.”

Learning as partnership

5.53 “Mutual learning” occurs when organizations and customers learn from each other. The learning organization's aim goes beyond satisfying customers' expectations. Its aim is to make customers successful. This means that the organization thinks hard about how it should change — and how its customers might change — so that a creative and successful partnership can be established and maintained.

“I don't think twice about visiting industry because these visits are an important way of learning about client needs through observation and networking.”

5.54 The relationship between an organization and its clients can be maintained in several ways. The organization can learn to adapt to changing customer expectations, or it can try to alter customers' expectations. A better way is to try and change both itself and its customers in a mutually beneficial way.

“We must be able to learn from the experience of others, i.e. industry. We're not unique, even though government is different. We could at least learn what their mistakes are... but we don't seem to do that very much around here.”

5.55 In a learning partnership, both partners contribute significantly to the development of products and services. They work side by side to meet specific needs. As a customer uses the product or service, the organization learns further by observing the technical and social aspects of their application. Learning partnerships contribute to satisfaction and success for both partners.

“Don't be afraid to try things. Give up the apron strings on your own ideas. Tap the expertise of clients and others.”

How Learning Takes Place

5.56 An organization tends to use a specific approach to learning, depending on its type of work and operational circumstances. Approaches to learning range from straightforward mechanical learning to the conceptual learning necessary to change paradigms. The mature learning organization is able to use a variety of approaches, depending on the situation. Yet this ideal may be elusive because organizations tend to “get stuck” in habitual, familiar, comfortable approaches.

5.57 Organizational learning is like a spectrum that has no naturally defined boundaries or divisions. In spectrums, like those of colour or music, names of certain areas or points are created for convenience. The colour spectrum in the rainbow, for example, is divided into red, orange, yellow, green, blue, indigo and violet. Yet many half–tones and shades exist that do not have names.

Solving problems

5.58 Problem solving is the learning approach most commonly used in organizations. A group of experts, analysts or researchers defines problems and challenges and designs procedures to correct them. The procedures are documented in manuals and directives, and workers are trained to implement them. Periodically, a third group evaluates the results and reports back to the designers. In this way, organizations gradually improve their performance.

5.59 This may also be called the "blueprint" approach. All necessary information is prescribed on a blueprint for workers to follow. Their compliance with the blueprint is monitored, and corrections to the blueprint can be made only by the designers.

5.60 This type of learning is used in law enforcement agencies. Laws are made, and an agency enforces them, with individual officers carrying out their duties as legislated. They cannot change the law, no matter how much a specific situation may call for change.

5.61 The automatic pilot on an aircraft operates on the same principle. Until the settings are changed, the aircraft follows the course set by the pilot, no matter what conditions occur.

Forming paradigms

5.62 Consciously or unconsciously, every organization adopts a set of tacit assumptions and patterns of thought. We refer to such sets of ideas as paradigms, mindsets or mental models.

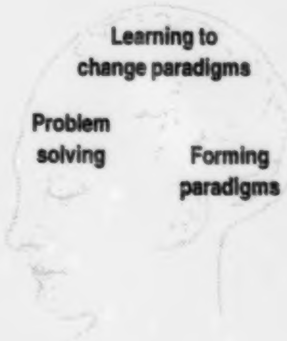
5.63 Some organizations adopt paradigms consciously and rarely change them. One example is religious organizations, which are admired by many for being rocks of stability in a chaotic world, but criticized by others for being out of touch with current thinking.

5.64 An example of unconscious adoption of a paradigm occurs in an organization where "messengers of bad news" are shot down by the boss. In such an organization, while workers and managers learn to report regularly to the centre, they also unwittingly learn to avoid risks and to cover up mistakes and failures. This unconsciously acquired mindset of "no risks" and "no bad news" may govern their actions to the point that it affects the organization's ability to perform intelligently.

5.65 Another example of such a mindset is a service organization's assumption that it knows what is best for customers and therefore doesn't need their feedback or participation in the planning of customer services.

5.66 Paradigms are usually followed as a matter of course. Most organizations do not examine them and often are not even aware of them. For instance, an organization "retires" people at a certain age, even though they may be eager and able to continue working. In doing so, it may lose some of its most valuable skills and knowledge.

5.67 As a result, an organization may feel current and confident, when it is in fact following a path to obsolescence. Yet because it is unaware of this, it is unable to change it. Making paradigms visible and accessible to review, discussion and change is another core process of organizational learning.



Changing paradigms

5.68 How can an organization break the habit of not examining its paradigms? How can it become aware of them? And how can it make its mental models accessible to examination and change?

5.69 Answering these questions exhaustively is beyond the scope of this chapter. We simply point out some of the main steps. We do so with particular reference to the management teams, which are ultimately responsible for setting strategy and policy in organizations.

Consciously or unconsciously, every organization adopts a set of tacit assumptions and patterns of thought.

5.70 The first part of the process is for those in the management group to consciously examine their own individual beliefs by looking at the decisions they have made in the past and the practices they support today. What are their underlying assumptions about the organization and its environment?

5.71 The second part is to deliberately engage in scenarios, or "What if ...?" exercises, to generate possible alternatives. The aim is to create, in an almost playful mode, options for different futures.

5.72 The third part of the process is to choose the most appropriate new approach. A note of caution is in order here. The old view no doubt survived as long as it did because it was acceptable and comfortable to many people. Few new approaches have that advantage. The management group must therefore take great care to explain the organization's new direction and guide all its members through the paradigm evolution.

"You must think about all aspects of change from the very beginning. Understand that what you are doing can have profound effects on organizational values, philosophies and behaviours."

5.73 The next part of the process is to act on the new paradigm. This means changing not only the strategies, structures and systems, but also assumptions and behaviours, so that they support and are supported by the new approach. This too will require leadership and persistence.

5.74 The final part of the learning process is twofold. It is the incorporation of the new or expanded paradigm into the fabric of ongoing organizational life. It is also the realization that even this new mental model is subject to examination as change goes on.

5.75 One example of paradigm evolution within the public service is the shift in control over departmental funding. Until recently, the government focussed on the number of person–years; now it focusses on the number of dollars. The new paradigm encourages departments to determine for themselves what level and number of people they need to carry out their mandate, within an overall operating budget.

5.76 Another example of paradigm evolution is the introduction of flexible hours. At one time, all employees in a department worked from "9 to 5". Now, many people can arrange their workday according to the workload and their personal needs.

5.77 Expanding this paradigm further is the practice of "tele–work". Traditionally, employees had to work on site. Now, instead of employees coming to work, work can come to the employees: Many people can do their job at home.

5.78 Still another example of paradigm evolution is revenue collection. In earlier days, Canadian customs officers were paid a percentage of the amount of customs duties they extracted from people. The underlying assumption was that this would "maximize" the amount of revenue collected. Organizational norms changed over time, and today the objective of the revenue–collecting departments is to collect the "correct" amount of revenue.

5.79 Such a paradigm could evolve even further. Instead of seeing itself as simply a tax collector and enforcer, a revenue department might see itself as a partner in pursuing success for both itself and taxpayers. For example, the department might say to a private sector corporation: "Of all the profit you make, we take 30 percent; the more you make, the more we take. It is therefore in the government's interest to see that you become increasingly successful. Instead of focussing on our internal efficiency in processing your tax returns, we will focus on helping reduce your costs in preparing them. Rather than spending a million dollars on electronic scanners to read forms, we will use that money to find ways to eliminate forms entirely so that you can report to us electronically."

5.80 Examining and modifying mental models is more than a one–time adjustment. Organizations need to realize that it is an ongoing process.

Suggestions for the Public Service

5.81 The purpose of our study was to explore the topic of organizational learning. In this final section we offer suggestions for the public service. We hope to encourage wide discussion and action.

5.82 Not all of these actions need to be formal. Encouragement and support for teams at all levels to learn new ways of achieving their goals can go a long way toward fostering a learning culture. Learning teams could become antibodies to bureaucratic inertia. This would be entirely within the spirit of Public Service 2000, which this Office fully supports.

The function of norms, standards and rules

5.83 Every society and organization has rules that liberate its members from uncertainty and confusion; they provide a framework of consistent, predictable conditions that allow us to live together with confidence. Rules of the road are an example. We all agree that we keep to one side of the road, that red means stop and green means go. We also know that these rules apply to everyone at all times, which makes it possible to travel even congested roads in relative safety. Similarly, air traffic controls provide peace of mind and safety to millions of travellers. Accidents still happen, but the situation would be chaotic without the rules.

5.84 Rules and routines, however, are counterproductive when they are enforced inappropriately or when they are followed for their own sake. Our study indicates that rules work best when they are understood and seen as worthwhile and when they are part of a learning cycle of periodic review and modification.

5.85 Learning organizations can develop and exist even in bureaucratic environments. They do so by reconciling the need for rules and compliance to the need for continuous learning and innovation.

Encouragement and support for teams at all levels to learn new ways of achieving their goals fosters a learning culture.

"We need a balance between individual liberty and an overly imposed system. We have to empower, cut restrictions. As a manager you have to have confidence in the people who work for you ... you have to know your people and their track record ... you have to trust them until they demonstrate otherwise."

Partnership with customers

5.86 Government organizations carry out two very broad functions. They provide products and services to customers and they seek compliance with rules and regulations. These two functions co–exist and are integral to the management of the nation's affairs.

5.87 Some government activities, such as health services and income support, are readily accepted and eagerly awaited, while others, such as revenue collection and the various inspection services, may be resented or even resisted.

5.88 If the public service is to become a learning organization, it must see itself as an interactive partnership with its customers. The aim of this learning partnership is to collectively achieve results that are valued by society.

5.89 This means that organizations need to give much thought to defining who their customers are. It also means that organizations continually need to learn not only about the products and services they produce, but also about the ways in which customers accept,

The aim of this learning partnership is to collectively achieve results that are valued by society.

use and comply with them for the benefit of society.

5.90 This in turn requires that public service organizations develop and deliver both their services and their regulations in a way that leads to maximum acceptance and use and voluntary compliance by customers. We consider that engaging in such learning partnerships with customers is a core process of organizational learning.

Fostering a culture of learning

5.91 We mentioned earlier that organizations are regularly engaged in some mode of learning. Most have formal training programs, many have research and development activities, and some periodically scan their environment for changes and new developments. Quite often, these activities are distinct from day–to–day operations, and the knowledge gained is not disseminated throughout the organization. The result can be a patchwork of individuals with advanced knowledge who are cut off from each other and from the main body of the organization.

5.92 The learning organization tries to bring everyone up to the same knowledge level and to encourage further learning both individually and in teams. Teams would be seen as "communities of practice" that learn both formally and informally and serve as building blocks of the learning culture. Embedded in this approach is the recognition that learning is the bridge between work and innovation.

5.93 Our study indicates that the learning organization develops the capacity to carry out three processes that form the core of organizational learning. These processes are:

- strongly encouraging and supporting individual learning, and then embedding the results of that individual learning into the culture and practices of the organization;
- reviewing and modifying the organization's basic assumptions and mental models to ensure a continuing fit with a changing environment;
- engaging in learning partnerships with customers to produce results that are valued by society.

5.94 The process of engaging in learning partnerships with customers should drive and guide most of the other learning activities, because it is most closely linked to the organization's raison d'être.

5.95 In discussing to what extent we should make suggestions in this chapter, we were torn between two views. Some advisors warned against making any suggestions, because they might be used like a checklist or a recipe. Others argued that the study yielded such rich insights that it would be a shame not to include specific instructions for managers.

5.96 We followed a third option. We compiled the following list of questions for managers. Through the process of looking for, finding and applying answers within their organization, managers can begin building a learning culture.

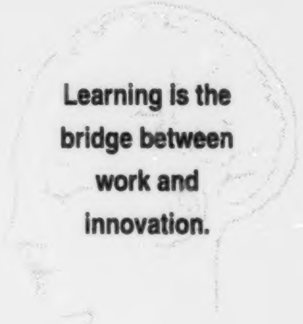
- Has the organization articulated an overall purpose? Do its members understand it? Are they committed to it? Is there provision to re–examine it periodically in light of changing circumstances?
- Does the organization have a framework of values and operating principles that must be observed, but within which members are encouraged to learn and to find innovative ways of improving performance?
- Do all members of the organization feel that their work is valued and that they contribute to the creation of the organization's products, satisfy customers' needs and add to the well–being of society?

- Does the organization see change as an opportunity to be welcomed, instead of a threat to be resisted?
- Is the organization aware that mental models are often acquired and held unconsciously yet govern the organization's strategies and actions?
- Does the organization regularly examine and challenge its mental models of reality to ensure that they fit with reality itself?
- Are people at all levels of the organization encouraged to learn, to acquire new skills, to experiment, participate in pilot projects and make suggestions for innovation?
- Are the results of individual learning being distributed throughout the organization? Are they being embedded in the practices and processes of the organization as a whole?
- Does the organization use both success and failure as sources of learning that will lead to future improvement?
- Is the organization receptive to a diversity of views and new ideas from both within and outside the organization?
- Does the organization seek to discover and deal with the causes of problems, rather than simply addressing their symptoms? Is it aware that problems may be caused by several interrelated factors?
- Is the organization periodically reassessing who its customers are and how it can sustain a productive learning partnership with them?
- Does the organization understand that organizational learning is a continuous process rather than a one–time transformation?

In conclusion

5.97 Learning in a traditional system typically takes place through analyzing and planning, and then controlling compliance with the plan.

5.98 The learning organization can still operate in a traditional way, when appropriate, but it is particularly skilled and able to learn effectively from its own actions in real situations and from learning structures such as simulations and experiments. To retain flexibility, it does not always plan every last detail before action and implementation begin.



Learning is the bridge between work and innovation.

5.99 The learning organization is able to reach beyond formal analysis to make use of insights and tacit learning. This includes the ability to know things without being able to fully explain their theoretical underpinnings.

5.100 An organization, like life itself, is subject to cycles: centralization is followed by decentralization, product focus by customer focus, hierarchical structure by flat structure. Yet the learning organization does not just circle around, go back to the beginning and make the same mistakes again. It takes its understanding to ever higher levels, with learning as the heart of its system. Instead of simply repeating cycles, the learning organization progresses in an upward spiral, a spiral of continuous learning and innovation.

Chapter 6

Information for Parliament

Departmental Reporting

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Information for Parliament

Departmental Reporting

Assistant Auditor General: Ronald Thompson
Responsible Auditor: Jeff Greenberg

Main Points

6.1 In the early 1980s, the government reformed the Estimates and introduced a new package of information for Parliament on departmental spending: Part III of the Estimates. This change led to considerable improvement in reporting, but, as was generally agreed, it was limited to annual spending.

6.2 Yet the business of government is complex and the instruments it uses are varied, only some of which are reflected through annual spending. Parliament should expect and receive a regular accounting on the exercise of the entire business of government: in a phrase, global stewardship. The Part IIIs should change to meet this proposed global stewardship paradigm, and they should be produced and reported on a cycle that could vary among departments.

6.3 Both parliamentary committees and government departments would be better served by these cyclical, in–depth reviews of departmental "global stewardship" within the current system of annual parliamentary approval of the Estimates.

6.4 While this method of reporting would mean more and better information, it need not mean more printed text. Existing technology provides an emerging opportunity to produce shorter, stewardship–based printed Part IIIs with additional information stored in electronic libraries. This additional information would be updated at least annually and made available on request, electronically and in printed form.

6.5 Accounting for "global stewardship" does not end with a better Part III. Ministers' speeches, answers to questions in Parliament, testimonies before committees by ministers and officials are all occasions to satisfy the need for disclosure by government. The quality of reporting should be a preoccupation of the mind, in living up to the ideals of responsible government.

Background: The Institutional Setting

Parliament, confidence and the Estimates

6.6 Since Confederation, Parliament has fulfilled its annual obligation of dealing with the government's request for authority to spend money in the next fiscal year. In doing so, Parliament has followed the well–established tradition that it does not govern; governing is the executive's responsibility. Parliament's duty is to satisfy itself on behalf of the Canadian public that the Crown's ministry is competent and has the full confidence of the House of Commons.

6.7 There are a number of means that parliamentarians use in the House to fulfil this duty. For the Opposition and Government backbencher, they include such things as oral and written questions, statements, debate and motions. In response, the Government tries to maintain confidence through a variety of reporting vehicles including the tabling of reports, speeches, answers to questions, and testimony before committees. In addition, it tries to manage the parliamentary agenda by using such means as closure, time allocation, and control over the raising of revenues through taxation (the Business of Ways and Means) and the spending of money (the Business of Supply).

6.8 A necessary procedure of the Business of Supply is the tabling of the Estimates (called votes). This procedure sets in motion the opportunity for Parliament to examine detailed transactions or activities as a means for considering the competency of the executive. The related vehicle for voicing parliamentary displeasure at this time is a motion to reduce or reject a vote in the Estimates. The Government responds to such motions as criticism of its competency, and naturally opposes them. On the rare occasions when such motions prevail, they almost inevitably end in the dissolution of Parliament and an election.

6.9 The tabling of the Estimates, and the measure of their usefulness, are set against this procedure that has stood the test of time since the early days of Confederation.

Parliament does not govern; governing is the executive's responsibility.

Reform of the Estimates

6.10 Since the first Estimates were tabled in 1867, there have been three changes to their form and content: in 1938, 1970 and 1981. The last reform took place after a review of financial management and accountability by the House of Commons Standing Committee on Public Accounts, the Office of the Auditor General and the Royal Commission on Financial Management and Accountability (the Lambert Commission). The newly created Office of the Comptroller General was given the task of responding to the recommendations.

6.11 Both the Lambert Commission and this Office recommended in 1979 that financial accountability would be better served if the government would report its spending plans in the spring with the Estimates, and on past performance in the autumn. The expectation was that this autumn report would eliminate the need for most departmental annual reports and departmental information in the Public Accounts, by amalgamating the best of both and eliminating the rest.

A necessary procedure of the Business of Supply is the tabling of the Estimates. This procedure sets in motion the opportunity for Parliament to examine detailed transactions or activities as a means for considering the competency of the executive.

Part III of the Estimates and accountability

6.12 In response, the government of the day proposed that Parliament and government would be better served by limiting reform to the Estimates. This led to the creation of a new three–part Estimates report. Part I would be the expenditure plan for the entire government while Part II, the Main Estimates, would support the annual spending legislation, the Appropriation Bill. Part III of the Estimates, also called the departmental expenditure plans, would contain forward–looking information on expenditures as well as information on past performance. The government's reasons for limiting the reform to the Estimates were accepted as reasonable by members of the Public Accounts Committee and other Members of Parliament. The reform project also had the full support of the Office of the Auditor General.

6.13 In hindsight, this decision may well be one reason for frustration about the Part IIIs both in Parliament and in government. The Part IIIs are Estimates documents that report on spending plans and on results against previous plans. They are designed to be completely consistent with the structure and content of Part II of the Estimates and the associated Appropriation Bill. With the exception of adequate performance information, they have come a long way in meeting the information needs about annual spending they were intended to cover. In a sense they have become the most established vehicle for departmental reporting to Parliament.

The government sometimes engages in activities that are not well reflected in the annual spending process, or that are organized in a way inconsistent with the Estimates structure. When that happens, a gap is created in that the Part IIIs do not represent the complete accountability document.

6.14 But governments sometimes engage in activities that are not well reflected in the annual spending process, or that are organized in a way inconsistent with the Estimates structure. When that happens, a gap is created in that the Part IIIs do not represent the complete accountability document.

Reporting on Stewardship: The Full Range of Departmental Activities

Government's business is complex

6.15 Government is in the complex business of serving the public interest and, in so doing, managing its substantial resources judiciously. The instruments it uses to achieve this mission are varied. Parliament has a right to expect and receive a regular accounting on the exercise of all these responsibilities. Annual reporting that focusses on compliance with spending authority does not reflect these broader duties and obligations to preserve, maintain, and foster the government enterprise: in a phrase, "global stewardship".

Since Confederation, the relationship between Parliament and government has changed

6.16 For the first 70 years after Confederation, government stewardship responsibilities were relatively simple and modest, and reasonably well reflected in the annual appropriation of money. World War II and its aftermath changed Canada into a modern state. It also changed the way government operated, and changed the old relationship between government and Parliament.

6.17 On the spending side, new economic and social programs sprang up that involved substantial transfers to provinces and individuals, including programs for health, education, fiscal equalization, pensions and child support. These were permanent programs requiring continuity in funding. To run them, Parliament gave government continuing authority to draw funds from the Consolidated Revenue Fund without the need for annual parliamentary approval.

6.18 From 1962 to 1991, these statutory programs grew from $3.1 billion to $93.0 billion, or from 46 to 66 percent of total expenditures.

6.19 Also on the spending side, the government occasionally relies on the private sector to help carry out its mission. For many years the government, through loan guarantees, has encouraged the private sector to undertake, or to provide financial assistance to, projects considered to be in the public interest. The rationale for this kind of government backing is that, without it, the private sector might otherwise not make the investment. For example, in the 1960s loan guarantees to students under the Canada Student Loans Program began to expand, and they continue today. More recently, much of the federal government support for energy megaprojects like Hibernia and the NewGrade Upgrader has been through loan guarantees. Last year these potential liabilities, excluding events such as native land claims, amounted to about $8 billion.

6.20 There are also illustrations on the revenue side that demonstrate the pervasiveness of the government's use of instruments that fall outside the regular annual appropriation process. Vote netting, for example, allows departments to reduce their gross expenditure requests to Parliament by using the revenues they collect to offset spending.

6.21 On a much larger scale, tax expenditures — which include deductions, exemptions, credits, reduced rates, or deferrals — are a way of using the tax system as an instrument or set of instruments to pursue economic and social purposes. When we looked at this in 1986 we estimated, based on the 1985 Department of Finance *Account of Selective Tax Measures*, that tax expenditures amounted to $28 billion annually, the equivalent of more than a quarter of the value of expenditures for that year.

6.22 The growing use by modern government of a variety of instruments to get the job done is shown in other ways. The resources under the protection of the federal government are vast. The Canadian public, through Parliament, expects the government to act responsibly in its stewardship over both physical assets and liabilities, which range from buildings and ships to the preservation of historic sites, from protection of employee pensions to protection of the environment. One of the most visible instruments the government uses are regulatory programs which influence public behaviour through government actions ranging from education to persuasion, to enforcement. Regulation over the environment, and the implementation of the government's environment strategy, show how significant the government's influence can be without involving substantial increases in expenditures.

6.23 These wide–ranging responsibilities are far more pervasive and complex than could ever be captured in the Estimates process, or reflected in conventional financial statements. In an age of scarce public resources and growing debt, seeking ways to see that things get done by or through others, rather than spending money to do them, becomes increasingly important.

In an age of scarce public resources and growing debt, seeking ways to see that things get done by or through others, rather than spending money to do them, becomes increasingly important.

6.24 This does not diminish the need to provide information for the Estimates and to report results against plans; it does mean that there is still considerable room to disclose the entire business of individual departments and agencies — in other words, "global stewardship".

Our View of Adequate Departmental Reporting

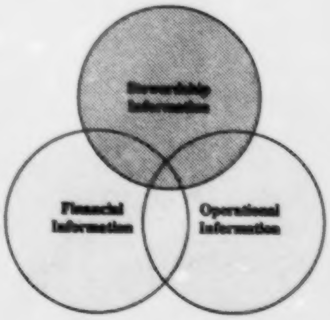
6.25 In our view there are three categories of interrelated information that require full disclosure and that are vital for maintaining the confidence of Parliament: stewardship information, financial information, and operational information (see Exhibit 6.1).

Stewardship information comprises information on the broader duties and obligations to preserve, maintain, and foster the government enterprise, seen from a macro perspective

6.26 Stewardship information would include a description of the organization's mission, its major lines of business, the way it is structured, the instruments it uses, its strategic targets and objectives for achieving the mission, and performance information

Exhibit 6.1

Categories of Information



showing to what extent these objectives have been met. It should also include recognition of the departmental responsibilities for managing significant public resources under its control.

Reporting on stewardship by senior management of an organization means articulating its mission in a manner that enables it to determine its success.

6.27 Reporting on stewardship by senior management of an organization means articulating its mission in a manner that enables it to determine its success. Clarifying the mission can be the single most important planning task for management because it allows it to focus on the purpose of the organization, to call attention to what it believes is important, and to set measurable goals toward achieving that purpose. It cannot be seen simply as a collection of every program, activity and sub–activity of the organization.

6.28 If done well, it can and should form the basis for a relatively brief stewardship report that focusses on strategic and macro–level information. Detailed supportive information, described below, has to be available and easily accessible but need not be printed with the stewardship report.

Financial information would reflect all a department's financial activities, even those that do not require parliamentary spending authority

6.29 We have already indicated that it is common today for the government to use a variety of instruments and financial resources to see that things get done. Apart from obtaining Parliament's approval for their administrative costs, much of the financing to see that these activities get done takes place with private sector support. Loan guarantees and regulation such as environmental protection are just some examples.

6.30 In addition, when the government purchases physical assets like ships and buildings, it does not recognize them as assets; it simply pays for them and treats their purchase as an expense, like office supplies. In a sense, the government's view is "a dollar is a dollar is a dollar." There is no recognition that some spending creates assets that continue to be used in succeeding years, if properly maintained. If these expenditures on capital are not recognized as physical assets, we run the risk of ignoring or delaying the need to maintain them; in other words, out of sight, out of mind.

6.31 We believe that departmental financial information for Parliament must reflect all the financial resources and instruments employed by a department, whether or not they involve annual spending.

6.32 To a large extent, stewardship information and financial information overlap. We should expect this because financial information is related to the business of the organization.

6.33 We should also expect to find that reported financial information reflects the way Parliament authorized the expenditures. This may create a dilemma when the lines of business differ from the structure in the Estimates. In such cases financial reporting should reflect both; there should always be an accounting for the cost of carrying out the lines of business at the macro level. But there should also be a cross–walk relating these costs to the Estimates.

Operational information would include more detailed information in a variety of areas

6.34 Operational information would clearly be linked to the financial category and, like financial information, would flow out of stewardship information.

6.35 It would include information on the business of the organization; administrative issues that are particularly significant to MPs; human resource management issues; and cost comparisons over time. In addition, it would include information on evaluation studies that contribute to the economy, efficiency and effectiveness of the organization.

6.36 It would also include specific information Parliament has called for in, for example, legally required annual reports. This would be consistent with the amendments to the *Financial Administration Act* and announcements in the February 1992 Budget, whereby departments could move to eliminate these required annual reports and to incorporate the information in the Estimates or the Public Accounts. The key is that the information continue to be collected on a timely basis.

6.37 It is important to continue the timely update of this operational information, whether it is published separately, incorporated into another report, or simply made available on demand.

6.38 In essence, operational information refers to regular information that would help departments display their competence in managing the department's business. We are not suggesting that new information systems would be required, nor are we calling for a replication of management information. Operational information for Parliament should flow directly from current management information, but in the same way that reports are prepared for Parliament today, it may have to be massaged and summarized. We have already stated that managing is the business of the executive, not Parliament. Parliament's role is to be satisfied that the executive maintains the confidence of the House of Commons, and to influence the action of the executive through examination, questioning, and criticism.

Information for Parliament should answer four questions

6.39 As we developed this framework of information for Parliament, we also considered whether enforcing adherence to it would require a detailed set of rules and instructions. We concluded that there is a need for a balance between some control at the centre and delegation of responsibility to those entrusted with stewardship. In striking this balance, we believe that global stewardship reporting would be well served if the following four questions were answered:

- **What are the department's mission and lines of business?**
- **How does the department carry out its lines of business to achieve its mission?**
- **What are the department's strategic objectives for realizing its mission, and plans for managing the significant public resources under its control?**
- How did the department do in meeting its objectives, and how much did it cost?

Criteria for information for Parliament

6.40 Information for Parliament ought to meet three overall criteria — relevancy, reliability and understandability. To be relevant, the information should be meaningful, complete, and timely, and answer our four questions. To be reliable, the claims made should be consistent from one information source to another and over time, and able to stand the rigor of validation. And to be understandable, anyone not versed in the language of the public servant or in the details of the department's organization should be able to comprehend the information. See Exhibit 6.2 for a graphical representation of this reporting framework.

There are limits to the amount of information that can be absorbed

6.41 Parliament is a busy place and even the most diligent reader cannot possibly absorb the amount of material its Members currently receive. We also recognize that MPs have varying needs: some want a simple, high-level overview of a department; others who

We believe that departmental financial information for Parliament must reflect all the financial resources and instruments employed by a department, whether or not they involve annual spending.

might have a deep interest in a department want to know considerably more about its business; others may simply want enough to inform their constituents, for example through their "householder" magazines. The challenge is to package information in a way that satisfies all parliamentary users.

6.42 Ten years ago, when the last reform of the Estimates took place, user–friendly information technology was in its infancy. Today, there are many such technologies available that can access more information and that take into consideration the tremendous range of user skills with computers. We believe that it is possible to make information better, to make more of it available and to make it less burdensome than the current proliferation of paper.

We believe that it is possible to make information better, to make more of it available and to make it less burdensome than the current proliferation of paper.

6.43 The financial and operational information we have described could be made available in printed form as well as through a variety of electronic media, ranging from on–line interactive databases to self–contained electronic libraries. At present, a popular method of managing large amounts of information is CD–ROM, a technology where one computer compact disc holds more information than 10 of our annual Reports, in both official languages. We recognize that, in the very near future, this electronic library approach may be supplanted by on–line databases. Our concern is that we must start now, in the most user–friendly way, but remain sufficiently flexible to accommodate changing technology.

Exhibit 6.2

Reporting Framework

	Relevant	Credible	Understandable
What is the department's mission and lines of business?			
How does the department carry out its lines of business to achieve its mission?			
What are the department's strategic objectives for realizing its mission, and plans for managing the significant public resources under its control?			
How did the department do in meeting its objectives, and how much did it cost?			

6.44 Moving this way would naturally lead to some additional costs, in both the technology and the gathering of information. On the information side, virtually all text information produced today is already in electronic form on computer. Making selected information available through electronic libraries means deciding what information is important, cataloguing it properly, meeting common standards of compatibility and ensuring that access to this information is user–friendly. However, we recognize that there are costs to collecting information and that these costs must be weighed against the benefits of providing it. For information that management requires, the cost of providing it to Parliament is incidental. But sometimes the information needs of management and Parliament are not synonymous. When this occurs, the associated benefits and costs must be assessed by both users and suppliers before proceeding.

6.45 But even with additional costs, there really is no choice. The proliferation of information is such that it is no longer feasible to print all available information, nor is it possible to ferret through written texts for selective information without new search technology. And finally, the next generation of users, including MPs, will increasingly expect information to be available electronically. In our view, there is no choice but to proceed in this direction today.

How Current Reporting Measures Up

6.46 We have so far described the concept of "global stewardship" and the related information we think would be appropriate for Parliament. In this section, we summarize our assessment of current reporting against our view of appropriate information for Parliament. Those readers wishing to see the detailed findings can read them in the Annex to this chapter (paragraph 6.91).

6.47 We explored the extent to which a selected group of departments were providing information of sufficient breadth to describe their stewardship responsibilities. We used as our framework the matrix of four questions and three criteria shown in Exhibit 6.2.

Departmental information is not broad enough

6.48 Current departmental reporting does not provide the breadth of information needed to convey the global stewardship duties and obligations of departments. This means that when departments engage in activities or use instruments that are not reflected in spending for the coming year, they often do not report these in the Part IIIs. Examples include new loan guarantees for megaprojects like Hibernia, commitments to development banks for assistance to developing countries, and new programs delivered through changes in the tax system rather than through expenditure.

6.49 We also found that the way departments manage and carry out their business is not always consistent with the way they report in the Part IIIs. The Department of National Defence is an example of a department whose framework for reporting to Parliament is different from its internal management framework. This should not be construed as a criticism as such, even though such a practice may lead to difficulty in understanding a department's business.

6.50 When the business of government was relatively simple and the day–to–day spending of money reflected its business, reporting on expenditure captured the essence of "global stewardship". But government business has changed, and for years, even before the recent growth in debt, government has relied on a varied set of instruments to carry out its business. Reporting has not kept pace with these complexities. And today, with government looking for ways to curtail spending, but continuing to see that its business gets done by making greater use of other instruments, we are concerned that its disclosure against spending alone will miss the mark even more than it has in the past.

6.51 In fairness to the departments, the reporting practices, particularly in the Part IIIs, are generally consistent with policies and guidelines established for them. The one exception is the previously reported weakness in reporting results, performance and effectiveness.

6.52 In summary, through our assessment we found that, while information on annual spending is well covered, there is considerable room for more openness by management about its global stewardship role. However, there are some real constraints to this. The next section describes some of them.

While information on annual spending is well covered, there is considerable room for more openness by management about its global stewardship role.

Constraints to Better Reporting

6.53 As part of the work for this chapter we consulted both users and suppliers of information. On the user side, we met with the Public Accounts Committee and the Liaison Committee of the House of Commons. We also met with individual parliamentarians. On the suppliers' side, we held individual and roundtable discussions with senior public servants. The common message that both groups expressed was their frustration with current reporting.

Parliamentarians' concerns about information

6.54 Users of information, the MPs, indicated that they were unhappy with reporting for three reasons. First, they are expected to use the Part IIIs when voting Supply, to have a better understanding of the requests for program resources. Yet they told us that the Supply process is not a meaningful exercise to them. They can't influence spending plans during Supply because, under our current system of responsible government, any changes would be viewed as a loss in confidence in the ability of the government to manage competently. In fact, even though the various votes in the Estimates are referred to committees for review, there is no requirement that committees actually report their views on the Estimates.

The common message that both parliamentarians and public servants expressed was their frustration with current reporting.

6.55 An outward sign of MPs' frustration over their lack of influence on Supply is that there are very few committee meetings held on the Estimates. Even worse is the smaller number of committees reporting back to the House on Supply. To illustrate this, for the 1991–92 Estimates, 20 formal committee meetings were held to discuss the $158 billion to be spent that year, down from 101 meetings in the previous year. Those meetings resulted in only one committee report to the House on the Estimates for the 1991–92 fiscal year; in the previous year, not one committee reported on the Estimates.

6.56 Second, MPs told us that if they were to undertake reasonable reviews of departments it would be very difficult for 20 or so standing committees to examine more than 80 Part IIIs each year. They also told us that, in those Part IIIs they do examine, there is much repetition from one year to the next because the business of departments does not change all that often.

6.57 Third, they told us that the Part IIIs are not helpful reading to understand the business of the departments. They find that there is either too much information or too little; they cannot always tell what departments are doing, or how much things cost; and they cannot get a reasonable perspective on performance. Added to this are the increased demands on their time from constituents, special interest groups, caucus and party duties. The result is that, even if the information were there, they would have little time to devote to gaining the perspective on departments they feel they should have.

6.58 In short, with respect to the Estimates process, the Part IIIs are not very useful because MPs cannot alter spending plans for the current year. And with respect to an overall understanding of departments, they are not useful because they do not describe the business of departments completely and succinctly.

Departmental concerns about current reporting

6.59 The suppliers of information also expressed considerable frustration with current reporting. In their case, the targets were the Office of the Comptroller General (OCG) and the MPs.

6.60 With respect to the OCG, senior departmental officials told us that the high degree of central control over the form of the Part IIIs left them with little or no flexibility in their approach to reporting. They told us that the *Guide to the Preparation of Part III of the Estimates* is very restrictive and reads more like a directive than a guide.

6.61 The policy for the Part IIIs, as stated in the *Guide*, is that each document is to be fully consistent with the presentation in Part II of the Estimates, and to reflect only departmental activities and programs included in the Operational Planning Framework approved by Treasury Board. This policy virtually guarantees that departmental reporting will reflect only approved spending, both annually voted and that under continuing authority. There is no requirement for reporting on the global stewardship of the liabilities, substantial physical assets, loan guarantees, tax expenditures and other such instruments that a department may be responsible for managing.

6.62 The *Guide* also specifies that each Part III shall be prepared in accordance with the instructions issued by the OCG. This means that each Part III contains information in increasing levels of detail, starting at the department level and ending with the activity/sub–activity level. Yet some departmental heads and deputy heads are stewards over operations or activities that don't fit this pattern. Furthermore, the instructions do not let a department choose the appropriate level of detail for informing Parliament about its operations.

6.63 Officials of the Office of the Comptroller General stress that they do allow for flexibility, but they also acknowledge that it is much easier for a department to stay within the prescribed structure. Change is more difficult than uniformity. To reinforce compliance with the Office of the Comptroller General guidelines, the deputy heads are asked to sign a 'representation letter', which states that the document:

> "...is presented in accordance with Treasury Board policy and instructions and the disclosure principles contained in the *Guide to the Preparation of Part III of the Estimates*."

6.64 Both departmental and OCG officials agreed on their frustrations with the lack of attention they believe MPs give to written material departments provide. One senior departmental official summed up this frustration as follows:

> "We met one (Commons) committee last week. If any of them had read the Estimates they certainly didn't care to reflect it... At the moment we have been able to identify two audiences that pay any attention at all to our Part III. One of them is the Office of the Comptroller General; the other is people who are looking for jobs in our Department."

6.65 Sorting out these constraints. We have considerable sympathy with suppliers of reports who believe that they are simply not used. Yet the real concerns and frustrations of MPs about the business of Supply suggest that there is no quick and easy solution to this dilemma.

6.66 We interviewed a number of people knowledgeable about Parliament, including people who were involved in the major reform of the Supply process in 1968. They reminded us that the business of Supply is the time when government presents its spending plans to Parliament. Parliament, in turn, examines them with a view to testing the competency of the ministry. It has been, and still is, the government's business to govern competently while holding the confidence of Parliament, and Parliament's business to continually test that competency.

6.67 But there are added strains today on this system of responsible government. The business of governing is a complex one, made increasingly so by growing debt. At the same time, demands on our elected representatives grow as constituents and special interest groups compete with the political party, caucus, and Parliament for their attention. Sometimes these increasing pressures erupt as frustrations over issues like accountability.

6.68 Through all of this, we believe that the essential principle that must be maintained is that the business of government must be transparent, irrespective of Parliament's use of the information. There will always be a need for a document of record that describes the stewardship of individual departments, and that is sufficiently flexible to accommodate changing circumstances.

6.69 Finally, while it may sound obvious, the more parliamentarians use the information provided, and the more feedback they give to its suppliers, the more responsive it will become.

Summary Observations and Recommendations

The essential principle that must be maintained is that the business of government must be transparent, irrespective of Parliament's use of the information.

The need for stewardship reporting

6.70 The reform of reporting that took place over ten years ago was a reform of the Estimates. It led to the introduction of the departmental expenditure plans, the Part IIIs, which have become the government's principal departmental reporting vehicle to Parliament. Their introduction has also contributed to considerable improvement in the reporting of financial information, particularly annual spending. However, the responsibility of ministers and senior public servants to manage the entire range of duties and obligations of departments is far more extensive than is reflected by annual spending. We call the overall management of, and accountability for, these broader duties and obligations, "global stewardship".

6.71 Departments should compile and make available information not only on annual spending but also on their global stewardship responsibilities.

6.72 The policy for the Part IIIs should be revised to emphasize reporting on global stewardship responsibilities of departments and on the way they are carried out.

Frequency of reporting and review

6.73 We believe that the business of departments and the broader interests of parliamentary committees would be better served by the production of a cyclical accountability document on "global stewardship", which would be based on the Part IIIs. We also believe that the one constraining factor to the timing of reporting is that it should take place at least once in the life of the "normal" three- to five-year Parliament.

6.74 The current policy for the Part IIIs calls for the annual tabling before Parliament of departmental expenditure plans, as distinct from the tabling of the Main Estimates that support the Appropriation Bill. But within our system of annual appropriations, such detailed annual departmental reporting no longer seems appropriate to government or to Parliament. In the government, the business of departments and agencies seldom changes to any great degree from one year to the next. In Parliament, the Supply process seems so constraining that MPs tell us they find little reason to review government spending plans with much conviction. Furthermore, they tell us that their committees lack sufficient time and appropriate information to review the global stewardship responsibilities of departments.

6.75 Individual departments and agencies should produce printed stewardship documents based on the Part IIIs, on a multi-year cyclical basis, in accordance with a schedule to be jointly determined by Parliament and the government.

6.76 Parliamentary committees should undertake in-depth cyclical reviews of departmental spending and stewardship in accordance with a predetermined reporting schedule.

Information technology and reporting to Parliament

6.77 Earlier in the chapter we described our view of adequate departmental reporting that included three categories of information: stewardship information, financial information, and operational information. Not all this information should be provided in printed form. We believe that only the stewardship information should appear in the new, shorter, cyclical Part III. This would include some financial and operational information of strategic importance to the executive of the department. More detailed information from the other two groups, including performance and effectiveness information, and material eliminated from previous annual reports, need not be included in this new Part III but must be accessible.

6.78 We recognize that our call for stewardship–based Part IIIs, backed up by additional information, could lead to departments having to make available different and, in some cases, more information for Parliament. This, however, does not mean more printed text.

6.79 When the current method of Estimates reporting was developed some ten years ago, personal computers were in the infancy stage and electronic user–friendly information systems were virtually non–existent. We believe that current technology offers an emerging opportunity to tailor information to specific user needs.

6.80 The government should designate an official with sufficient authority to ensure that each department develops an electronic library of additional information, with flexible access to it either electronically or in printed form.

6.81 Each new stewardship Part III should contain an annotated bibliography describing what additional information is available in the electronic library along with a clear explanation on how to access it.

6.82 Making information in electronic libraries accessible is necessary, but by itself is not sufficient. That information must also be kept up–to–date and MPs must be informed about changes to it, including any significant alteration to the department's main lines of business. This requires a discipline in the system to replace the current need for a full report each year.

6.83 Each year, at Estimates time, the government should table a document containing the updated annotated bibliography for every department and agency not producing a new stewardship Part III for that year. This summary document should also contain information on any significant changes to departmental lines of business, to allow parliamentary committees to consider altering their departmental review schedules.

6.84 Before concluding, we need to make one qualification: we have not defined the number of reporting entities. In the last few years, approximately 85 departments and agencies produced Part IIIs. What is an appropriate reporting entity, and the total number, is a matter we leave to the government and Parliament to decide.

Conclusion

6.85 The purpose of this chapter was to take a fresh look at departmental reporting in the context of responsible government. We indicated that reporting should be more reflective of the global stewardship responsibilities entrusted to ministers and senior officials of departments. We also indicated that this will become increasingly important as government tries to avoid substantial increases in expenditure and debt.

6.86 We called for a reform of reporting to allow the Part IIIs to become global stewardship documents and to be produced cyclically rather than annually. We also proposed that both parliamentary committees and departments would be better served by cyclical, in–depth reviews of departmental spending and stewardship, rather than the required annual reviews based on the Estimates.

6.87 Finally we indicated that, although our proposals may lead to more information, that need not mean more printed text. Existing technology offers an emerging opportunity to produce shorter stewardship–based printed Part IIIs, with supporting information stored electronically, maintained on a timely basis, and readily available.

6.88 In recommending these changes, we could have gone much further. We could have proposed a specific model for the new Part IIIs and for the supporting information. We deliberately chose not to do this because we wanted to concentrate on the principles of reporting, not the details. We also recognize that there is no one correct model that is consistent with our proposals. The interpretation and implementation of our proposals could vary across departments and parliamentary committees. Our hope is that the government accepts our proposals and works with departments and Parliament to reform reporting for the coming decade.

6.89 In conclusion, we come back to some remarks we made earlier in the chapter. Confidence is fundamental to our parliamentary democracy and reporting is an integral element of that. Maintaining that confidence does not end with new departmental stewardship reporting. The quality of ministers' speeches, answers to questions, testimonies before committees, all form part of the need for openness in government. The quality of that reporting, for ministers and officials, should be a constant preoccupation of the mind, a willingness and eagerness to foster the ideals of our system of responsible government.

6.90 Yet in saying this we recognize that maintaining a vibrant system of responsible government is a heavy obligation. At times, increasing frustrations and pressures on government and on Parliament periodically erupt in conflict over accountability that sorely test this system. We offer no panacea, but encourage our elected representatives and senior officials to remember the vital role that reporting plays in our system of responsible government.

Annex

Assessment of Current Reporting

6.91 In the chapter we described the concept of "global stewardship" and the information we think is appropriate for Parliament. In this Annex we provide detailed information on our review of current departmental reporting as measured by our framework (see Exhibit 6.2). We are aware that current reporting in the Part IIIs is based on the *Guide to the Preparation of Part III of the Estimates*, not on our framework. This means that "deficiencies" relative to our concept for reporting are not things the preparers of the Part IIIs could be expected to have corrected. They are measured by a standard we are proposing, not one in place today.

Deficiencies relative to our concept for reporting are not things the preparers of the Part IIIs could be expected to have corrected. They are measured by a standard we are proposing, not one in place today.

6.92 **The assessment.** We reviewed the information provided by a sample of seven organizations to see what each said about itself. The seven organizations we chose and our reasons for selecting them are shown in Exhibit 6.3.

6.93 The exercise involved examining the information in regular reports produced by these organizations, not just the Part III, to determine whether it met our criteria.

6.94 **Scope of the assessment.** In determining the scope of this assessment we noted that Members of Parliament are inundated with documentation: press releases, speeches, committee proceedings as well as regularly reported documents. This makes it virtually impossible for MPs to decide on what is important from a department. We believe that the information MPs need to hold the government accountable ought to be included in, or be accessible through one of the regular departmental documents. As a result, we limited our assessment to departmental information regularly reported in documents such as departmental annual reports, the *Public Accounts* and the *Estimates*, including the Part IIIs, the most established vehicle for departmental reporting to Parliament. We also examined some selected significant additional reports that added to the understanding of a department.

6.95 We also limited our review to what the organizations said about themselves in written text, not how they might subsequently have clarified or interpreted what was written. We took the view that writers of reports have to make themselves clear, since most cannot expect to have the luxury to interpret or clarify what they write.

6.96 In addition to these seven organizations, we have drawn examples from other chapters of this Report that include observations on reporting to Parliament, as well as Correctional Service Canada, which came to our attention during the course of our work. Using our framework for reporting, the following examples illustrate the lack of breadth in current departmental information.

6.97 **What are the department's mission and lines of business?** We wanted to know whether departments were giving readers a sense of their lines of business and the instruments they used. We found that this was not the case. For example, the Department of Finance is the department with key responsibility for tax policy and programs that generate more than $100 billion each year, and for all tax expenditures. While there is some information indicating that the Department is responsible for tax policy, there is little about its stewardship responsibility for major areas such as tax expenditures, or references to where it can be found.

6.98 In its Part III, the Department of Forestry describes its mission and provides details of its activities in research and forestry development. However, it does not discuss how its responsibilities are related to provincial forestry responsibilities. This is especially important since ownership

Exhibit 6.3

Organizations Selected For Assessment

Finance: a central agency and a policy department, one of whose major outputs is the annual budget.

Taxation: a department with a very visible product.

Forestry: a department with specific areas of federal responsibilities working in close co-operation with the provinces, which manage the forest resources.

Fisheries and Oceans: a largely decentralized department having responsibilities for fishery resources and all matters respecting oceans not by law assigned to any other department.

Medical Research Council: a small agency that distributes multi-year grants but whose budget is appropriated annually.

National Defence: a security conscious department with a large stewardship role over enormous capital assets and land and with a large annual budget.

Energy, Mines and Resources — Megaprojects: an activity dependent on federal involvement and with active participation from provincial governments and private organizations.

and management responsibility for the bulk of Canada's forests rests with the provinces. In our view, a reader's understanding of this material would be enhanced if the Part III clearly outlined the respective roles and responsibilities of the federal and provincial governments in the forestry sector.

6.99 For some of the organizations we examined, a more complete picture of their business was available from reading their Part IIIs in conjunction with other regularly produced publications. For example, National Revenue – Taxation periodically produces a document called *Inside Taxation*, which provides a good overview of the Department's operations. The Medical Research Council produces the annual *Report of the President*, which provides some insight into the Council's direction and current research. The National Defence annual report, *Defence 90*, provided more descriptive information on such areas as the Canadian Forces Training System, capital projects, recent operations and peacekeeping missions. *Defence 90* also provided information on subjects not included in the Part III, such as the Department's role in the Northern region and in environmental protection. It would have been useful to have these additional sources of information cross–referenced in the Part III in a way that informs the reader how the information would help to fill out the departmental profile. However, this was not the case.

6.100 The megaprojects supported by Energy, Mines and Resources (EMR) are an example of a major line of business not reported because it does not fit within the Part III reporting structure. As described in Chapter 14, EMR is heavily involved in the megaproject business through the Hibernia project off Newfoundland, the Bi–provincial Upgrader in Lloydminster, and the NewGrade Upgrader in Regina. Furthermore, this year the Department plans to spend approximately $300 million, or 36 percent of its budget, on megaprojects. Yet it does not provide any description of its stewardship responsibilities for these projects.

6.101 How does the department carry out its lines of business to achieve its mission? Some departments carry out their business differently from the way they report it in their Part III. For example, National Defence states clearly in its Part III that it does not manage its funds the way it reports to Parliament in its Part III. The Department also indicates that it has a committee structure for managing and for internal accountability, but gives no insight into how it operates. Our Office has been saying for a number of years that the Department could report to Parliament on the basis of defence capability, which is not the way it currently reports.

6.102 In Chapters 10 and 11 we report on Canada's international financial commitments and contingent liabilities. The Canadian International Development Agency (CIDA) provides assistance to developing nations through regional development banks. The Department of Finance has made commitments to provide debt relief to a number of sovereign nations. In both cases Canada is potentially committed to substantial amounts of money, well over $3 billion each, yet CIDA and the Department of Finance provide little information on their use of these financial instruments in their Part IIIs, or where to find information about them.

6.103 What are the department's strategic objectives for realizing its mission, and plans for managing the significant public resources under its control? Departmental plans beyond the coming fiscal year are generally not provided to Parliament, because the *Guide to the Preparation of Part III of the Estimates* does not require it. For most departments, internal reports to Treasury Board contain some information on longer–term goals and plans, but these are not generally made available to Parliament.

6.104 Operational uncertainties and risks are important elements in understanding how a department plans to carry out its mission. Yet these are rarely discussed. For example, the federal government has provided loan guarantees through EMR for the NewGrade Upgrader project, amounting to $275 million. Because there is no current expenditure, the Department does not provide any information on this project in its Part III. The only reference to this contingent liability is one line in Table 11.14 of Volume I of the 1990–91 *Public Accounts*. As mentioned in Chapter 14, megaprojects involve many risks. These risks are not discussed in the departmental documents. How departmental officials manage such risks to reduce or eliminate the potential impact is a fundamental aspect of their stewardship responsibilities.

6.105 **How did the department do in meeting its objectives, and how much did it cost?** In their Part IIIs, departments generally provide measures of activity, usually in terms of production statistics. But without information on previous plans or on the quality of the production, it is not possible to assess what these productivity statistics say about performance. To illustrate this, we recognize that National Revenue–Taxation has improved its reporting of performance in a number of areas, like telephone inquiries handled, by providing comparisons over time, but it would be even more helpful if the Department provided standards or targets to put this performance in context. In addition, more quality–of–service measures, such as the number of attempts to reach a Tax Office or the length of time to issue refunds, would enhance the production information provided.

6.106 Some departments do not inform the reader how they have performed in relation to their missions or strategic objectives. In its Part III, Forestry states that its mission is "to promote the sustainable development and competitiveness of the Canadian forest sector..." It is difficult for a reader to assess the Department's performance relative to its objectives and mission based on the information presented in its Part III.

6.107 Correctional Service Canada provides a clear statement of its corporate objectives based on its mission statement. However, in complying with the guidelines for the preparation of Part IIIs, it presented performance information by activity, and not by corporate objective. Correctional Service officials told us they intend to reflect performance information based on their corporate objectives in the 1993–94 Part III.

6.108 In the cases we examined where departments did provide performance information, we found some weaknesses. One department, Fisheries and Oceans, has improved its presentation of targets and expectations to provide more understandable information, allowing for a quick comparison of results against previous years' targets and expectations. However, in some cases targets are general and results specific, making it difficult for the reader to assess performance.

6.109 CIDA's Part III states that its support of the regional development banks has been very effective. However, as described in Chapter 11, CIDA does not report the results expected or the results achieved from the grants, payments and guarantees Canada provides to the regional development banks.

6.110 Forestry was unable to provide information to support some performance claims made in its Part III. One claim it made was that the Forest Resource Development Agreement with Alberta ($11 million over a five–year period) has contributed to more than $3 billion of new industrial investment that will utilize Alberta's aspen resources. We were not provided with any evidence to establish that the investment was the result of the agreement, as claimed in the Part III.

6.111 One fundamental piece of departmental information is the cost of a particular activity or line of business. Many departments have distinct administrative activities that are reported separately in departmental documents such as the Part IIIs. These separate administrative or overhead activities ranged, as a percentage of total operating costs, from a high of 33 percent to a low of 17 percent in the departments we examined.

6.112 We are not trying to compare the overhead burden of the various departments because that would require us to be satisfied that they define and report administration in a consistent way. Nor are we expressing an opinion on the size of administrative units. But we are highlighting that these overhead costs do not exist in isolation from the other departmental activities. If, for example, a department reduced or eliminated a major activity or line of business, we would expect to see some savings in the form of reduced administration. Yet no attempt is made to relate administrative costs to the major lines of business they support.

6.113 In Chapter 22 we describe an audit of the RCMP's largest program, contract policing. We concluded that, with respect to this line of business, the RCMP does not show the actual cost of the program against the revenue it receives from the provinces, territories, and municipalities.

6.114 We believe that deputy heads of departments and their executive committees ought to address these concerns about cost information if they are to exercise their stewardship role well. In our 1987 chapter on Financial Management and Control, we stated that reporting "...on the efficient and effective use of resources depends very much on the adequacy of the planning systems they represent. ...Because measures of efficiency and cost information rarely exist, they are rarely reported in the Part IIIs."

6.115 **Understanding the text.** We examined whether the Part IIIs were understandable. To do this we held focus groups to reflect on their clarity. The groups, who had been unaware that these documents existed, were encouraged about their potential usefulness to the average Canadian. Although some members of the focus groups felt they could understand what the departments were about, for the most part they found that the writers had lost sight of their audience and were too bent on volume rather than quality. The focus groups were also frustrated by the lack of attention to visual presentation in Part IIIs.

Comprehensive and Special Audits

The following Comprehensive and Special Audits have been conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Committee (PSAAC) of the Canadian Institute of Chartered Accountants.

Chapter 7

Payments to Employees Under the Work Force Adjustment Policy

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Payments to Employees Under the Work Force Adjustment Policy

Assistant Auditor General: Robert Lalonde
Responsible Auditor: Jacques Goyer

Main Points

7.1 The primary objective of the audit was to determine the extent to which payments in lieu and other related benefits granted between 1986 and 1991 under the Work Force Adjustment Policy were well founded and in keeping with the intent and letter of the Policy.

7.2 We found significant differences in the way the provision regarding payments in lieu was administered in departments. There were instances where it was well managed and instances where it was not managed in a satisfactory manner. In each case, there were some common characteristics.

7.3 Some 32 percent of the 396 payments examined were well founded and in keeping with the intent and letter of the Policy. Thirty–five percent were judged to be without foundation. In addition, we found that a number of payments — 29 percent — were called into question, given the reasons for and the circumstances in which they were made. We were unable to conclude in 4 percent of the cases. Our findings were indicative of trends and patterns, notably regarding payments made between April 1990 and December 1991.

7.4 While payments in lieu have facilitated work force adjustment situations, there has been a gradual deterioration in the administration of this provision, notably because of weaknesses in the management framework in departments and at the central agency level.

7.5 In our opinion, there is a need to clarify and better understand the roles and responsibilities of central agencies and departments and to ensure that all players concerned work in partnership. We suggest that there must be a change in mindset about empowerment, control and accountability. We also suggest that consideration be given to developing policies or mechanisms to deal with specific departmental problems such as work force renewal and other personnel problems. We believe that the emphasis needs to shift from reducing personnel to eliminating unnecessary and non–essential work. We also believe that there is a need for managers to absorb, or at least take into account, the full cost of their decisions regarding payments in lieu.

Background

The Work Force Adjustment Policy

7.6 The objective of the Policy is to minimize layoffs of indeterminate (permanent) employees affected by work force adjustment situations through the provision of alternative employment opportunities. Work force adjustment situations occur when a deputy minister or an authorized officer decides that the services provided by one or more indeterminate employees are no longer required because of lack of work or discontinuance of a function. Up to 31 August 1992, the Policy applied to employees at all levels. Work force adjustments can result from such things as expenditure constraints, new legislation, program changes, technological change, privatization, reorganization and productivity improvement.

7.7 The Policy, originally established in the sixties, was agreed to by the National Joint Council and approved by the Treasury Board. The Council is an organization made up notably of representatives of the Treasury Board (the employer) and bargaining agents.

7.8 **Introduction of "payment in lieu" (cash–out).** The Policy was amended in June 1986 by the introduction of payments in lieu to employees declared "surplus to requirements" and scheduled to be laid off, who resign before the date of their layoff. The Policy requires a minimum of six months advance notice to surplus employees before their layoff, except in special circumstances. The payment is a lump sum equal to regular pay for the period from the date of resignation to the date of the scheduled layoff — a maximum of six months or 26 weeks' pay.

7.9 Payments in lieu were expected to:

- permit surplus employees who so desired to quit immediately if there was no work to be performed; and
- save costs of employee benefits, of retraining, and of finding a job for those opting for such a payment.

7.10 The payment in lieu option was introduced to facilitate the task of redeploying permanent employees possibly affected by the government's decision in May 1985 to reduce the size of the public service by 15,000 person–years over five years. The stated objectives of the government were a reduction in the size of the ongoing public service, the achievement of a more efficient public service and a reduction of salary expenditures.

7.11 Several conditions were to be met before a payment in lieu could be authorized:

- The employee had to be declared surplus.
- The employee had to request such a payment.
- The employee had to relinquish statutory entitlement to priority consideration for positions in the public service.
- The work had to be discontinued as of the resignation date, and the employee not replaced.
- The deputy head or an authorized officer had to certify that no additional person–year, salary or operating costs would be incurred in having the work done in any other way during the period for which the employee would receive payment.
- The payment was to be granted at management's discretion, with the understanding that a request was not to be unreasonably denied.
- The recipient had to sign a declaration agreeing to terms of reimbursement, if reappointed during the period covered by the payment in lieu.

Payment in lieu was introduced to permit surplus employees who so desired to quit immediately if there was no work to be performed.

7.12 Payments in lieu could be funded under Treasury Board Vote 5 — Government Contingencies — if they resulted from the government's decision to reduce the size of the public service and if funds were not available within departmental appropriations. One of the purposes of Vote 5 is to make up for paylist shortfalls. Departments access Vote 5 by way of a submission to Treasury Board. Where work force adjustment situations resulted from departmental initiatives such as reorganizations, payments were to be funded through departmental appropriations.

Departments are responsible for managing work force adjustment situations and are accountable to Treasury Board for the implementation of the Policy.

7.13 Introduction of a "waiver" and a "separation benefit". In 1988, the Secretariat informed departments that Treasury Board had given advance approval in principle to a waiver of reduction of annual allowances payable to eligible employees whose employment was being terminated involuntarily in work force adjustment situations. An annual allowance is a pension actuarially reduced to take into account the fact that it is paid earlier than normal. The waiver eliminates the penalty reduction of five percent for each year that the employee is less than age 60 or has less than 30 years of service at the time of the separation. To be eligible, an employee must be at least 55 years of age and have 10 years of pensionable service. The maximum waiver is 25 percent of pension. The waiver was to be approved without question by Treasury Board upon the recommendation of the deputy head for surplus employees who had received payment in lieu.

7.14 In 1989, amendments were made to the Policy. One such amendment was an entitlement for surplus employees to a guarantee of one year's retraining to facilitate their appointment to another position. Another was the introduction of a separation benefit of one week's pay for each year of service up to a maximum of 15 weeks' pay. This benefit was to be paid to surplus employees resigning or being laid off provided they were entitled to opt for an immediate pension or annual allowance and had not received more than one month's retraining.

7.15 In the 1991 Budget Speech, the government stated that it would consider legislation if it was unable to reach an agreement with bargaining agents to make major changes to the Work Force Adjustment Policy. Because of long negotiations, the Policy — and the provision for payment in lieu — initially scheduled to expire 31 March 1991, was extended first to 29 June, then to 30 September, to 31 October, to 30 November and finally from 1 December to its expiry, which occurred 14 December of that year. A significantly revised Work Force Adjustment Policy came into effect on 15 December 1991.

7.16 The accountability framework for managing work force adjustment situations and administering the Policy. The Policy in effect during the period covered by our audit described in some detail the roles and responsibilities of the Treasury Board Secretariat, the Public Service Commission, the National Joint Council, departments and employees in work force adjustments. Exhibit 7.1 summarizes these roles.

7.17 Departments are responsible for managing work force adjustment situations — with the assistance of the Public Service Commission — and are accountable to Treasury Board for the implementation of the Policy. The Policy required that a number of control mechanisms be in place in departments, such as the monitoring and the evaluation of the administration of the payment in lieu provision. Some of these control mechanisms were relaxed in the context of Increased Ministerial Authority and Accountability (IMAA) and Public Service 2000 initiatives. For example, in June 1990, deputy heads were authorized to sub–delegate the authority to approve requests for payments in lieu.

7.18 The Policy also stated that the Secretariat is responsible for monitoring certain aspects of the Policy, including payments in lieu, and may require deputy heads to justify their decisions. The Work Force Adjustment Policy is one of the key human resource management policies taken into account by the Secretariat in its assessment of departmental performance.

Objectives, Scope and Criteria of the Audit

Objectives

7.19 The audit was designed to determine:

- whether payments in lieu and other related benefits had been made in accordance with the intent and letter of the Work Force Adjustment Policy;
- if costs had been incurred in having the work done during or after the period for which an employee had received payment; and
- the nature and extent of review, monitoring and other controls used in administering the Policy at the departmental and central agency levels.

Scope

7.20 The audit was initially designed to cover all payments in lieu and other related benefits provided under the Work Force Adjustment Policy from July 1986 to December 1991. For a variety of reasons, such as the lack of an audit trail and turnover in management ranks, we focussed our examination on payments made between April 1990 and December 1991, just before the major revision of the Policy.

7.21 We reviewed the activities of the Treasury Board Secretariat and the Public Service Commission in relation to their roles and responsibilities in the administration of the Policy. In addition, we reviewed, analyzed, and consolidated information on payments in lieu and other benefits obtained from departments and agencies that had more than 1000 employees and for whom Treasury Board was the employer.

7.22 A detailed examination was conducted in departments that accounted for some 43 percent of all payments in lieu since 1986. We reviewed a total of 396 payments. For

Exhibit 7.1

Main Roles and Responsibilities in Relation to Work Force Adjustments

Treasury Board Ministers (TB)

- Recommend resourcing levels to Parliament
- Approve Work Force Adjustment Policy
- Allocate contingency funds – Vote 5
- Approve waiver of reduction of annual allowance

Treasury Board Secretariat (TBS)

- Review resource proposals
- Recommend resource levels to TB
- Inform departments of cutbacks
- Provide advice to departments on Policy
- Monitor application of Policy
- Review submissions of "pension reductions"
- Assess departmental performance
- Approve surplus periods of less than six months
- Consider requests for retraining resources

Public Service Commission (PSC)

- Review staffing policies and procedures
- Assess qualifications of surplus employees
- Ensure priority consideration for employment
- Market "surplus" employees
- Propose retraining and approve eligibility
- Provide counselling
- Inform relevant bodies of priority referrals
- Identify areas of skill shortage for which surplus employees may be retrained
- Provide TBS with some statistics
- Audit application of Policy for TBS
- Inform TBS of results of audits
- Publish information on work force adjustments

Department

- Determine human resource requirements
- Consider alternatives to staff reductions
- Determine if staff cuts are needed
- Identify units of workers likely to be "affected"
- Redeploy, retrain and counsel employees
- Notify PSC of employees declared surplus
- Identify and notify "surplus" employees
- Pay the travel, relocation, retraining, separation and salary protection costs
- Terminate term and contract staff to assist placement of permanent employees
- Consider "surplus" or laid off people for appointment
- Establish control and monitoring mechanisms
- Inform PSC and TBS of major adjustments
- Inform and consult with unions
- Notify employees of layoff date
- Approve payment in lieu request
- Certify that no additional costs will be incurred in any way during "cash–out" period
- Request access to Vote 5 if needed
- Compile statistics and maintain records
- Account for implementation of Policy

Employees

- Seek employment actively
- Seek information about entitlements and obligations
- Provide information to assist in redeployment
- Consider job offers
- Accept retraining
- Request payment

National Joint Council (NJC)

- Review Policy periodically
- Provide interpretation of Policy intent upon request
- Hear grievances

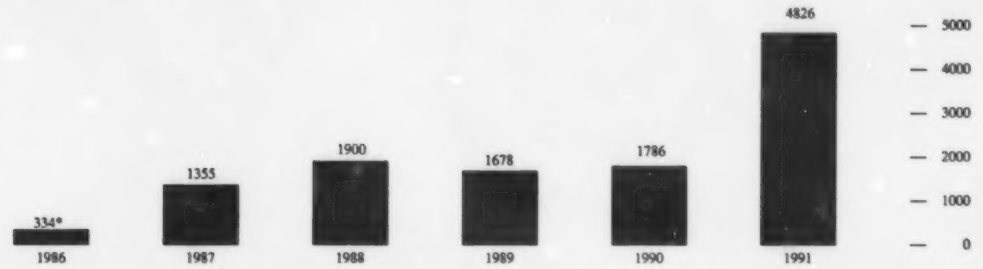
each payment examined, we sought to ascertain if a work force adjustment situation existed; if the process followed was in keeping with the intent and letter of the Policy and if the decision was thus justified, given the circumstances.

7.23 We reviewed available internal audit and other reports that were produced by the Secretariat, the Commission or departments concerning work force adjustment situations and/or the administration of the Policy. Where relevant to our audit, we included findings and observations in our report.

7.24 Finally, we reviewed numerous reports from both the private and the public sectors on downsizing practices over the years. We also

Exhibit 7.2

Distribution of Payments in Lieu By Year, 1986 to 1991



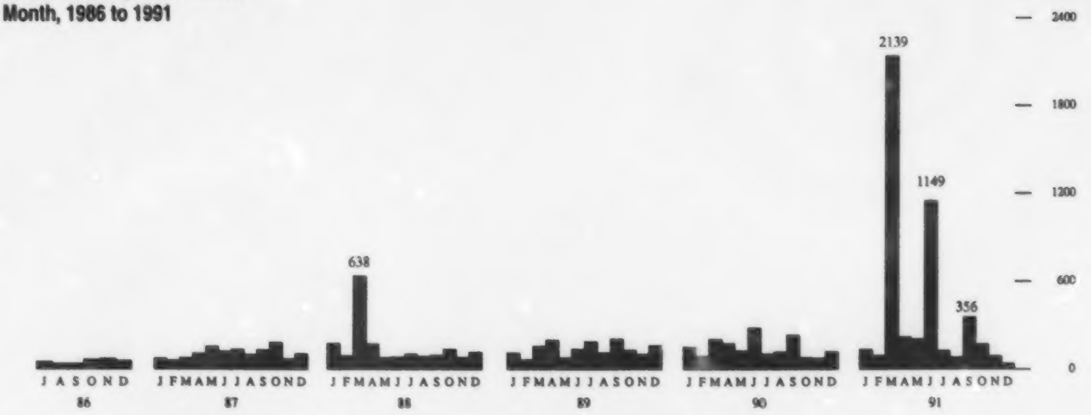
* Payments in lieu were introduced in June 1986.

Note: Graph based on payments for which information required for analysis was available.

Source: Departmental reports to OAG

Exhibit 7.3

Distribution of Payments in Lieu By Month, 1986 to 1991



Note: The peaks of March 88, March, June and September 1991 correspond to months when the Work Force Adjustment Policy was due to expire.

Note: Graph based on payments for which information required for analysis was available.

Source: Departmental reports to OAG.

interviewed a number of representatives of companies and experts who had extensive experience in downsizing.

Criteria

7.25 The provisions of the Work Force Adjustment Policy provided the framework for audit criteria. Where necessary, other central agency and departmental policies, directives and guidelines were also taken into account.

Observations

7.26 In this section we do not name departments where individual cases were examined, for a number of reasons including:

- The findings and the problems identified are indicative of trends and patterns and thus are systemic in nature.
- To prevent the identification and to protect the reputation of individuals.
- Recognition of the implications of potential legal actions against individuals or the Office.
- To respect the intent of the Privacy and Human Rights Acts.

Some 13,000 Payments in Lieu Were Made Between July 1986 and December 1991

7.27 On the basis of information obtained from departments, agencies and Treasury Board Secretariat, we estimate that some 13,000 payments in lieu were made to employees between July 1986 and December 1991, at an estimated cost of $260 million. From June 1989 to December 1991, we estimate that some 5,800 employees received the separation benefit. The Secretariat reported that some 1,700 waivers were also granted to recipients of payments in lieu. The total cost of payments in lieu, separation benefits and waivers granted since 1986, is estimated at more than $325 million.

7.28 Typically, the recipient of a payment in lieu was a person over 50 years of age with 18 years of pensionable service who had worked as a clerk or a program administrator in a large department. In addition, such a person received the separation benefit equivalent to 15 weeks of regular pay, for a combined lump sum payment equivalent to a maximum of 41 weeks of regular pay — some $30,000 on average. A typical waiver amounted to some $1,800 a year.

Some 13,000 payments in lieu were made between July 1986 and December 1991 at an estimated cost of $260 million.

7.29 In 1991, there was a substantial increase in the number of payments in lieu. More than 4,800 payments (or 37 percent of all payments) were made between January and December 1991 (see Exhibit 7.2). This is more than twice the number of payments made each year since 1986 — including 1987, when the government's five–year 15,000 person–year reduction program was considered to be at its peak. Analyses revealed that peaks occurred in March 1988 and in March, June and September 1991 (see Exhibit 7.3), months in which the Policy was expected to expire.

7.30 The option of payments in lieu appears to have been used more frequently to resolve reported work force adjustment situations in recent years. Exhibit 7.4 shows that the number of recipients of payments in lieu represented some 29 percent of the number of employees reported surplus by departments to the Public Service Commission in 1987, compared to some 64 percent in 1991. We found, however, that for a variety of reasons, departments have sometimes failed to inform the Commission that employees had been declared surplus, a requirement of the Policy. The numbers reported by the Commission are thus understated.

The option of payments in lieu appears to have been used more frequently in recent years.

7.31 The relationship between the number of payments in lieu made and the reduction in size of an organ-

Where work force adjustments were well managed, payments in lieu were usually well founded and in keeping with the intent and letter of the Policy.

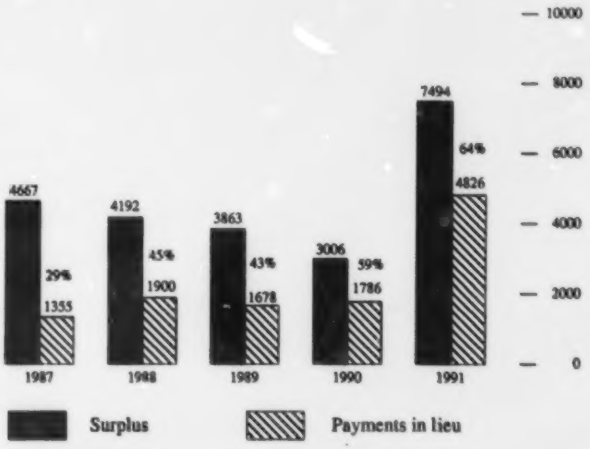
ization was not always evident. Unless there were significant changes in the nature or the level of certain activities of an organization to compensate for a reduction in others, we expected the number of payments to represent a fraction of the overall reduction in size because:

- the Policy's primary objective is to provide alternative employment, where possible, to minimize lay-offs; and
- good management practices, statements of officials and the Policy itself emphasize consideration of alternatives such as natural attrition, early retirements, termination of term/casual employment and contracted services, staffing freezes and the use of part–time, job sharing or seasonal employment, where such actions could prevent or minimize the number of involuntary separations.

7.32 Exhibit 7.5 shows that for work unit "A", the number of payments in lieu represented some 27 percent of the reduction of the person–year allocation over a five–year period. In unit "B" (see Exhibit 7.6) the number of payments have — with the exception of 1988 — consistently exceeded the reduction in person–years. In 1990–91 and 1991–92, unit "B" had its person–year allocation augmented to help it cope with an increase in activity levels. While there might be valid reasons that the number of payments exceeded person–year reductions in any given year — for example the elimination of a few clerical positions and the creation of a large number of professional jobs — we found that such imbalances were often one indicator of problems in the administration of the Policy.

Exhibit 7.4

Relationship Between the Number of Employees Declared "Surplus" and the Number of Payments in Lieu



Note: Graph based on payments for which information required for analysis was available.

Source: *Public Service Commission (employees declared surplus)*
Departmental reports to OAG (payments in lieu)

Significant Differences in the Way Work Force Adjustments and the Provision for Payments in Lieu Were Managed

7.33 **We found a number of instances where work force adjustment situations and the provision for payments in lieu were well managed.** They shared a number of characteristics (see Exhibit 7.7), although not all to the same extent.

7.34 There was a direct relationship between the presence of these characteristics and the good management of payments in lieu. In these instances, the recourse to payments in lieu was usually well founded and in keeping with the intent and letter of the Policy, and the payments were used in conjunction with alternatives such as attrition and redeployment. In one situation examined where a work unit was being eliminated, all employees were redeployed, and there were no payments in lieu.

7.35 **We also found a number of instances where work force adjustment situations were not handled in a satisfactory manner.** They also shared a number of characteristics (see Exhibit 7.7). In such situations, payments in lieu were used much more frequently and liberally, often in contravention of the Policy.

Characteristics of well–managed work force adjustment situations

7.36 An understanding of the purpose and context of the work force reduction. Where work force adjustment situations were well managed, managers knew what was expected of them and understood the circumstances leading to the decision to reduce the work force. Often, management had anticipated the decision of the government because it had grown out of their own review of the organization and because managers had spent months, if not years, studying the problem, alternative solutions and their implications. They knew what needed to be done and why. For example, one 1990 work force adjustment situation examined had been the subject of debate and planning since 1986.

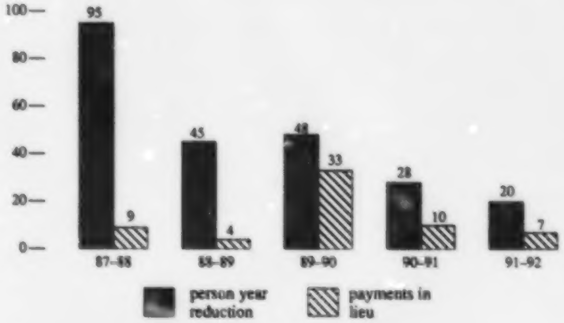
7.37 Leadership starting at the top that provided direction and fostered commitment through participation and communication. Senior management communicated clearly the nature and extent of the challenge faced and the objectives to be achieved; they conducted information sessions with staff at various levels — sometimes across the country — to explain the situation, its causes, the changes required and the process to be used in making the changes. Management was clearly in charge; they were perceived by staff members to be determined to meet the challenge and ready to provide the necessary support.

7.38 Time was made available for staff participation, and dialogue was used to elicit commitment and build up confidence among managers and other employees that the challenge would be met in an organized way, and that people would be treated fairly and humanely. Those managers likely to be affected were asked to review initial proposals and to present their own suggestions or ideas for staff reduction. These suggestions or ideas were given serious consideration before a final decision was made. While a significant amount of time was spent on planning, implementation was carried out swiftly.

7.39 Mobilization of the organization to "rethink" the work and program delivery and to tackle the challenge faced. Managers were not simply asked to cut staff; they were asked to rethink the work and to make substantial changes in the way they provided services and managed their activities. They had to do things

Exhibit 7.5

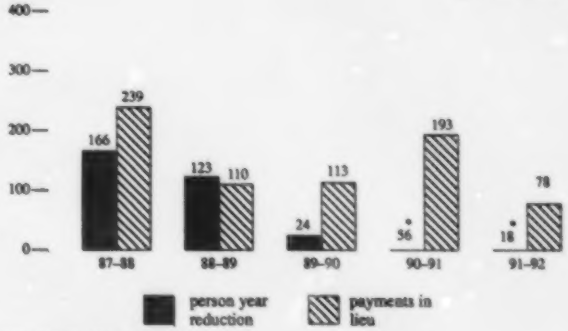
Payments in Lieu and Person–Year Reductions "Unit A"



Source: *Departments – (person–year allocation)*
Departmental reports to OAG (payments in lieu)

Exhibit 7.6

Payments in Lieu and Person–Year Reductions "Unit B"



* In 1990–91 and 1991–92, person–years increased.

Source: *Departments – (person–year increase/reduction)*
Departmental reports to OAG (payments in lieu)

Where work force adjustments were poorly managed, payments in lieu were used more frequently and often in contravention of the Policy.

"differently" or "better". The nature and magnitude of such challenges required an organizational response and the mobilization of a significant portion of the organization, including support services such as personnel. In one situation, the unit had to redefine the nature of its relationship with external organizations in addition to transferring certain responsibilities to them. Remaining employees who had been direct providers of services had to become advisors. Some 70 percent of the staff in that unit had to be transferred, redeployed internally or retrained.

7.40 A management framework that included solid plans, the formation of ad hoc committees and support units for a co-ordinated and integrated effort. A management framework was put into place. Detailed action plans were prepared to ensure that the objectives would be met. Ad hoc committees at various levels, such as steering and local work force adjustment or implementation committees, were set up for the duration of the exercise, headed by senior line managers and supported by personnel and others as required. These committees reviewed action and implementation plans to ensure a co-ordinated and integrated effort.

Exhibit 7.7

Management of Work Force Adjustments: Comparison of Characteristics of and Effects on Payments in Lieu

Where well-managed

- An understanding of the purpose and context of the work force reduction;
- Leadership starting at the top that provided direction and fostered commitment through participation and communication;
- Mobilization of the organization to "rethink" the work and program delivery and to tackle the challenge faced;
- A management framework that included solid plans, the formation of ad hoc committees and support units for a co-ordinated and integrated effort;
- Measurable and definitive objectives;
- Control of the exercise through periodic reporting, concurrent evaluation, and other mechanisms to ensure that objecitves were met.

Effects on payments in lieu

- Considered one option among others.
- Usually well founded and in keeping with the intent and letter of the Policy.

Where poorly managed

- Senior management of the organization failed to provide leadership, direction and support;
- Planning was inadequate;
- No appropriate management framework was established; the opportunity to learn from experience was lost;
- Work force reductions were not used as an opportunity to "rethink" the work;
- Management relied on employees requesting payment in lieu to achieve the work force reduction.

Effects on payments in lieu

- Liberal interpretation of the Policy.
- THE only option.
- Usually without foundation or called into question.

7.41 The work force adjustment process was not managed in isolation from other activities. Staffing decisions were reviewed to ensure that any employee likely to be declared surplus would be considered for retraining or redeployment before any other person was hired. Payment in lieu situations were reviewed to ensure both justification and consistency. Personnel played an important and visible role by providing assistance to line managers in charge of the process and by providing information to employees on the Work Force Adjustment Policy. Exhibit 7.8 provides an illustration of a well-managed work force adjustment situation.

7.42 Measurable and definite objectives. The objectives to be achieved were clear and did not change as time passed, their achievement over time was measurable, and results appeared to be permanent.

7.43 Control of the exercise through periodic reporting, concurrent evaluation and other mechanisms to ensure that objectives were met. During the work force adjustment process, information flowed between the various committees and managers responsible for the implementation. Emphasis was on ensuring that objectives would be met and that the process would be fair and equitable. For example, committees received periodic reports on implementation and progress in relation to objectives. In turn, committees provided additional direction and support to managers responsible for implementation. Treasury Board Secretariat, the Public Service Commission and unions, were consulted prior to and during implementation; they were kept informed through formal reporting as well as informal discussions.

7.44 In some instances, there were audits or reviews of the work force adjustment process in mid–stream. Management did not wait until the work force adjustment was completed to learn from experience and to improve practices.

Characteristics of poorly managed work force adjustment situations

7.45 Senior management of the organization failed to provide leadership, direction and support. Where work force adjustment situations were poorly managed, senior management often failed to recognize the importance of managing work force reductions. It provided little or no direction, information or support to managers at lower levels. Senior management limited its role to processing requests for payments in lieu and rubberstamping decisions. This sometimes led to the perception, among lower level managers, that it did not care or that it was not important.

7.46 Planning was inadequate. Where management did not properly plan, options other than payment in lieu were often not explored. Where planning took place, it was short–term and carried out only at the local level. In some instances, employees whose jobs were terminated received payments in lieu soon after being appointed from term (temporary) to permanent positions. In other situations, positions similar to the ones vacated by employees receiving payments in lieu were created soon afterwards. In some instances, workers who had received payments in lieu were reappointed immediately after the end of the period covered by the payment. Better planning could have prevented such situations from occurring and could have reduced the cost to taxpayers.

7.47 No appropriate management framework was established; the opportunity to learn from experience was lost. Because of the shortcomings mentioned above, an appropriate management framework was not put in place.

7.48 The work force adjustment process was not co–ordinated or integrated with other activities, such as staffing. In one specific situation, workers who had received payments in lieu from one unit were found to be working in a similar unit nearby shortly after the end of the six–month period for which they had received payment.

Where management did not properly plan, options other than payment in lieu were often not explored.

7.49 Information that would have permitted management to track progress in achieving work force reductions and to determine the contribution of payments in lieu to that process was not

Exhibit 7.8

Case 1 – A Planned, Co–ordinated and Integrated Approach to Managing a Work Force Reduction

In this unit, managers were required to reduce the work force by 32 permanent employees with the objective of transferring responsibilities to external organizations.

Management took advantage of the opportunity to proceed with a much–needed reorganization as well as to redefine its relationship with the external organizations.

Early in the process, the manager of the unit informed all staff that a review would be undertaken. A committee of managers was set up to develop a strategy on how to address downsizing and to prepare a proposal to implement the reduction. A work force adjustment team composed of managers and personnel was also established.

Once the proposal had been developed, senior management visited each location and made presentations on the reorganization and plans.

The team met with the Public Service Commission and union representatives to explain the reorganization. Sessions were held with employees to answer questions about the Policy. Counselling was provided to individual employees upon request. A redeployment strategy was developed to ensure the orderly placement of employees. Employees were declared surplus in stages as the reorganization proceeded.

Redeployment activities were monitored, and steps — such as controls on staffing activities and release of term employees — were taken to maximize employment opportunities.

Twenty–one employees were redeployed, eight received payments in lieu, two retired and one was laid off. Payments in lieu examined were well founded and in keeping with the intent and letter of the policy.

collected. In many instances, Personnel had great difficulty in ascertaining the total number of payments in lieu made, even though deputy heads or other delegated senior officials had to approve each request, certify that no additional cost would be incurred in having the work done during the period covered by the payment, and ensure that the person would not be replaced. The difficulties in obtaining basic information from some organizations led us to conclude that controls, including those required by the Policy, were not always in place. Where controls existed, they were not always effective. In one instance, a review of payments in lieu was conducted by Personnel but it lacked rigour and failed to identify important problems and to bring them to the attention of senior management.

7.50 As a result of the absence of an appropriate management framework, managers did not receive feedback from senior management that could have helped them to learn from their practices and those of their colleagues.

Exhibit 7.9

Case 2 – The Work Force Adjustment Policy: A "Voluntary Early Retirement Incentive Package"

Measures contained in the 1991 Budget Speech led some managers to believe that there was a significant risk of having to deal with another round of painful work force reductions in the coming fiscal year.

Management anticipated that the government would require a reduction of person–years to compensate for the estimated 1991 salary increase of three percent (equivalent to a reduction of some 140 person–years in this unit).

Managers also feared that the Work Force Adjustment Policy — and its provisions for payments in lieu — would come to an end on 31 March 1991.

In March, the unit contacted employees over 55 years of age and asked them if they might be interested in leaving their employment earlier than planned with a cash–out.

Employees were given until the end of March to decide and to leave. There were 266 employees who opted for payments in lieu; they left during the last week of March 1991.

Because of the government decision to freeze salaries instead, the anticipated person–year reduction did not materialize. In fact, the person–year allocation of that unit was increased by eight in 1991–92. In addition to unnecessary expenditures related to payments in lieu, management had to initiate staffing actions to replace many of the departed employees.

Most of the payments examined in this unit were judged to be without foundation.

7.51 Work force reductions were not used as an opportunity to "rethink" the work. Work force reductions were not used as an opportunity to question the organization's provision of specific services or to reduce overhead, either because the reduction was perceived as relatively small or because the work force reduction was divided up among several units. The emphasis was on reducing the work force without much consideration of the effect on service to the public. Payments in lieu were routinely processed and approved. For example, one district office was instructed to reduce its total person–year allocation by 2.6 over one year. The manager of one of the four local offices in that district recommended approval of requests from three people in less than three months, leaving a potential gap in the provision of service to the public. All were approved without question.

7.52 Management relied on employees requesting payments in lieu to achieve the work force reduction. Management spent little or no effort to determine the nature and the number of positions to be eliminated or to identify employees likely to be affected. In some instances, the provision of the Work Force Adjustment Policy regarding payments in lieu was transformed into a "voluntary early retirement incentive package" in spite of the government's decision not to offer such a package, notably because of its perceived prohibitive cost. Case 2 (see Exhibit 7.9) provides an illustration.

7.53 Where employees were invited to volunteer, typically more employees than were required to meet the reduction target requested payments in lieu. Most, if not all, requests were approved. Management believed that doing otherwise would result in perceived inequities, frustration, grievances and morale problems. Often, the most experienced employees left, creating a significant loss of expertise and corporate memory in addition to creating serious operational problems.

In one unit, the chief and the assistant chief left at the same time, with nobody sufficiently experienced to take over. Often, in such situations, departing employees eventually had to be brought back or new employees had to be hired to ensure continuity of essential services.

7.54 These effects can be best exemplified by an excerpt from a report prepared subsequent to a work unit using "volunteering". In that unit, 68 employees had requested payments in lieu. All the requests were approved, and 48 employees left at the end of March 1991.

> "The effect of these cash–outs on the organization has been three–fold. Firstly, the effect has been the loss of many older, more experienced employees during a period of high workload. Secondly, the acceptance of cash–outs was disproportionate [to the number required], with some responsibility centres being left with a number of supervisory positions to fill. Thirdly, the timing of the cash–outs (with 70 percent leaving in March) gave little time or flexibility to local managers in terms of using the vacant positions for developmental assignments. *(sic)*"

7.55 Studies and surveys of downsizing practices reveal that one of the secrets of successful downsizing lies in carefully defining and designing the future organization and assessing the positions and skills required in the new structure before proceeding with downsizing. "Volunteering", as described, precluded this from happening.

Payments in Lieu Used for Reasons Other Than Lack of Work or the Discontinuance of a Function

7.56 We found a number of instances where payments in lieu were used for reasons other than those for which the Policy was specifically established, i.e. lack of work or the discontinuance of a function. For example, payments in lieu were used to facilitate work force renewal, to solve performance problems or to reward employees. Case 3 (see Exhibit 7.10) provides an illustration of the use of the Policy for work force renewal, while Case 4 (see Exhibit 7.11) provides an example of the use of payment in lieu to solve a performance problem.

Payments in lieu were used to facilitate work force renewal, to solve performance problems or to reward employees.

Significant Weaknesses in the Monitoring, Review, and Other Control Mechanisms of Central Agencies

7.57 **The parameters for monitoring the administration of the Policy were too narrow.** While central agency monitoring focussed on such important elements as the extent of redeployment of surplus employees, other key elements were not taken into consideration. For example, the extent of the use of payments in lieu, the

Exhibit 7.10

Case 3 – Use of Payments in Lieu for Work Force Renewal

In this unit, managers were informed of a requirement to cut 43 person–years because of budgetary cuts and changes in standards for resource allocation. Management had to react quickly to the situation.

A decision was made to call for employees to volunteer to be declared surplus and thus become eligible to request payments in lieu. Criteria for assessing requests were established to ensure that operational requirements, among other matters, would be taken into consideration.

Management accepted requests from 43 employees in order to meet its objective. Shortages were created at all levels, including the loss of two senior employees, one of whom was replaced. The other senior employee was temporarily re–hired more than six months later to assist with internal staffing of some of the vacancies that were created.

Our examination revealed that while the supply of new employees for this unit had been reduced to the minimum required to maintain the training program and expertise, it had been exceeding attrition for a number of years. Some recruits could not be assigned to duties for which they had been hired and trained.

While management contend that their approach in this case constituted good management practice, certain of the payments examined in this unit were judged to be either "in question" or without foundation because they were not in keeping with the intent of the Policy.

consideration of alternatives prior to declaring a work force adjustment situation and the relationship between payments in lieu and other indicators such as person–year reductions, changes in position and occupational profiles were ignored.

Treasury Board Secretariat did not have the information to effectively monitor payments in lieu because of deficiencies in the monitoring system.

7.58 The Secretariat did not have the information necessary to effectively monitor payments in lieu. The Policy stated that the Secretariat would monitor the administration of the provision regarding payments in lieu. To do this, the Secretariat intended, among other things, to rely on data obtained from the central pay system of the Department of Supply and Services and from the Priority Administration System of the Public Service Commission. Suspecting that there were shortcomings in the systems, the Secretariat conducted a review in March 1990 to assess the accuracy of the amounts shown to have been paid, to ascertain whether some term employees had received payments in lieu, and to determine if persons shown as having been reappointed during the period covered by the payments had reimbursed the Receiver General. The review identified problems with the information systems and concluded that the monitoring component was not working. Furthermore, some public servants were excluded from the system. A comparison between the number of payments in lieu reported by the Secretariat and those reported by departments as of 31 March 1991 showed a discrepancy of some 25 percent. In some instances, the discrepancy was more than 50 percent.

7.59 Departments did not always inform the Commission when employees were declared surplus, although they were required to do so by the Policy. As a result, some of the figures reported by the Commission for 1991 and possibly previous years, such as the number of employees declared surplus or the number of surplus employees reported as having left the public service, are significantly understated. For example, the Commission reported that close to 8,000 surplus employees retired or left the public service between 1986 and 1991. Since some 13,000 surplus employees received payments in lieu during roughly the same period, the number of surplus employees reported by the Commission as having left the public service is obviously low. Such information was to be used by the Secretariat in monitoring the administration of the Policy.

7.60 As a result of all these weaknesses, the Secretariat did not have the information necessary for deciding whether or not to have the Public Service Commission audit the administration of certain aspects of the Work Force Adjustment Policy. The weaknesses identified also prevented the Secretariat from effectively monitoring whether employees had been rehired during the period for which they were paid.

7.61 Weaknesses in the information system identified in 1990 were not addressed by the Secretariat because the Policy was coming up for its three–year review. We were informed that monitoring payments in lieu for the revised Policy, which came into effect 15 December 1991, is more complex due to an increase in the number of instances where recourse to payments in lieu can occur.

7.62 Weaknesses in the audits of the administration of the Policy. Treasury Board Secretariat has delegated the audit of the application of the Work Force Adjustment Policy to the

Exhibit 7.11

Case 4 – Using Payments in Lieu to Resolve a Performance Problem

The manager of a work unit was experiencing absenteeism and performance problems.

This manager was offered options, including the possibility of payments in lieu under the Work Force Adjustment Policy. The manager opted for the latter. Because of the nature of the position, the employee had to be replaced immediately.

While it may be argued that a performance problem was solved, it was outside the intent and letter of the Policy. Additional costs were also incurred.

Public Service Commission. Under the terms of a 1986 agreement concerning the audit of personnel policies, the Secretariat is responsible for providing to the Commission the audit criteria and information on procedures and systems to be audited, as well as data related to departmental operations in the areas to be audited. The Secretariat is also responsible for determining whether departments will be subject to or exempted in whole or in part from such audits. Twelve of the 31 audits conducted by the Commission from 1989 to 1991 included an assessment of the administration of the Work Force Adjustment Policy. Our review of the 12 audit reports revealed that few problems related to payments in lieu were ever identified and brought to the attention of departmental management or the Secretariat.

7.63 In our opinion, one reason for the Commission's failure to identify significant problems related to payments in lieu was that the audit program developed by the Secretariat was inadequate. For example, it did not include examination of the reasons for declaring a work force adjustment situation even though the existence of such a situation is an essential condition for authorizing payments in lieu. Furthermore, although the Secretary of the Treasury Board had written to deputy heads reminding them of their responsibility with regard to the monitoring and evaluation of the application of payments in lieu, the audit program did not assess whether departments had in place the controls to do so. In the course of our audit, at the request of the Secretariat, the audit program was modified and applied in one department. The Commission's auditors found some of the same problems we identified, such as positions not being abolished and others being staffed again.

7.64 In our opinion, weaknesses in the monitoring, review and control systems of departments and of central agencies have contributed to a gradual increase in the use of payments in lieu in situations where it was without foundation. These weaknesses have precluded an objective and complete assessment of departmental performance in administering the Policy. They have also prevented the Secretariat from having the information needed to question departmental decisions where warranted. In April 1992, all audit projects to be carried out by the Commission on behalf of the Secretariat were placed "on hold" pending a reassessment of the overall accountability framework and the development of performance indicators for human resource management.

Treasury Board Secretariat's comments: *The government is concerned about the inappropriate use of the payment in lieu provisions in the Work Force Adjustment Directive. The Report identifies cases where mistakes were made in applying the Policy. There have also been weaknesses in the underlying management system. To guard against future occurrences, the Treasury Board Secretariat and departments are working together on corrective action.*

The reassessment of the overall human resource management framework will be used to address the weaknesses in the central agency monitoring, review and control systems identified in the chapter.

Our review of the Public Service Commission audit reports revealed that few problems related to payments in lieu were ever identified.

Thirty-two Percent of the 396 Payments in Lieu Examined Were Well Founded and in Keeping with the Intent and Letter of the Policy

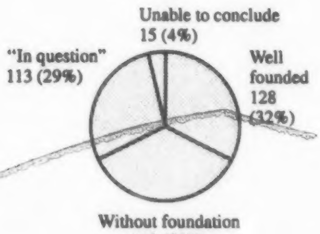
7.65 Of the 396 payments examined, 128 (32 percent) were found to be justified, i.e., well founded and in keeping with the letter and intent of the Policy, while 140 (35 percent) were found to be unjustified, i.e., without foundation.

Treasury Board Secretariat's comments: *Parliamentary consideration* *of the issues raised in the Report will be better served if there is no mystery about the identity or overall performance of the departments that were the subject of more detailed examination by the Auditor General. Departments are responsible for administering the Policy in their own jurisdictions and should respond to questions about their own actions. At the request of the Treasury Board Secretariat, and with the agreement of the departments concerned, a summary of the findings, by department examined and under the headings used by the Auditor General, will be available when the Report is made public.*

7.66 In addition, a significant number of payments — 113 (29 percent) — were categorized "in question", as illustrated in Case 3 (Exhibit 7.10). While these payments were often not in keeping with the intent or letter of the Policy, managers argued that positive outcomes were nevertheless achieved. In other situations, although management had achieved a reduction in size, less costly alternatives were available, such as terminating term employment. In other instances, the process used to achieve the reduction caused significant disruptions to operations and resulted in expenditures that, in our opinion, could have been avoided. We were unable to conclude in 15 (4 percent) of the cases. Exhibit 7.12 provides an illustration of our overall findings.

Exhibit 7.12

Results of the Detailed Examination of 396 Payments in Lieu



Treasury Board Secretariat's comments: *Many of the managers who engaged in the practices criticized by the Auditor General felt that their actions were "justified" because they saved taxpayers money, renewed their workforce, or resolved difficult personnel situations. A strong case can be made in many instances that this was indeed so, but the fact remains that they did not comply with the letter and intent of the Policy.*

7.67 In our opinion, our findings are indicative of trends and patterns regarding payments in lieu, notably in the months between April 1990 and December 1991.

7.68 A significant number of the payments judged to be without foundation were made in the March to September 1991 period and were the result of "volunteering" as described in paragraph 7.52 to 7.55 and Case 2 (see Exhibit 7.9). This situation appears to have been triggered by the February 1991 Budget as well as the anticipation of the expiration of the Policy and its provision for payments in lieu. The 1991 Budget Speech stated that salary increases were to be limited to three percent with the caveat that in 1991–92, if the government, through bargaining, was unable to maintain a freeze on operating budgets, each increase of one percent would result in the loss of some 2,000 jobs. In the end, the government decided, based on the fact that there would be no increase in pay, not to proceed with this reduction in jobs. About one–third of all payments in lieu were made between March and September 1991. If we exclude from our analysis those payments we examined that occurred in the peak periods of March, June and September 1991, our findings are not affected significantly.

Conclusions ... and Some Unanswered Questions

7.69 **Payments in lieu have facilitated work force adjustments.** The provision for payments in lieu, where properly used, has made it much easier to protect the employment of remaining employees and to handle work force adjustments. Managers have suggested that without payments in lieu, there would have been a greater number of layoffs over the years. In its report for the year 1991, the Public Service Commission reported that 1,277 employees were involuntarily laid off between 1986 and 1991.

7.70 The deterioration in the administration of payments in lieu has been gradual. There are indications that there has been an increase in the use of payments in lieu as the only option to resolve work force adjustments or other personnel problems. Emphasis has gradually shifted from redeployment and other alternatives to payments in lieu. Some of the reasons for the deterioration include:

- weaknesses in the management framework that have led to poor management practices eroding good ones;
- difficulties related to the identification of actual surplus situations;
- an emphasis on person–year reductions; and
- the availability of central funding.

As a result, the number of payments in lieu — and the cost to the taxpayer — has been significantly higher than necessary. Because of this and also because PS 2000 (the government initiative for the renewal of the public service) advocates greater devolution of authority to departments and managers, we believe there are important lessons to be learned from this experience and significant improvements that need to be made, notably to the management framework.

7.71 In our opinion, weaknesses in the management framework have led to significant differences in the interpretation and application of the Policy. Organizations that erroneously and liberally applied the provision of payments in lieu did not, and were not required to, improve their practices. As a result, there was a gradual erosion of managers' perceptions of "acceptable practices". This was evident, for example, in regions where many departments share accommodation. Managers reported that it was increasingly difficult to deny requests for payments in lieu from employees who claimed to know of similar requests in other organizations that were being approved. In our opinion, some managers felt obligated to lower their standards to avoid creating inequity and morale problems among their employees.

Treasury Board Secretariat's comments: *Discussions with departments are proceeding to establish what happened in cases where the Auditor General has determined that the Policy was used inappropriately or in unintended ways. As an initial step, the Treasury Board Secretariat has reviewed the Auditor General's findings with each of the departments in which the more detailed examinations were conducted and will work with them to ensure that necessary corrective action is taken.*

A significant number of the payments judged to be without foundation were made in the March to September 1991 period and were the result of "volunteering".

A need to clarify and better understand the roles and responsibilities of all players

7.72 There is a need to clarify and better understand the respective roles and responsibilities of central agencies and departments for managing work force adjustments and administering the Policy. Who is ultimately responsible for ensuring that work force reductions are achieved and that the intent and letter of the Work Force Adjustment Policy regarding payments in lieu are respected? If it is the Secretariat, where specifically does this accountability lie? If it is departments, how does Treasury Board ensure that departments meet their obligations? Who is responsible for ensuring that control mechanisms are in place and are working? Who is responsible for the establishment and the maintenance of adequate information systems and the provision of accurate information regarding work force adjustments and payments in lieu? Why were problems in the administration of the Policy not identified and promptly corrected?

Treasury Board Secretariat's comments: *Responsibility for administering the Policy and for applying it in* *individual cases lies with departments. Treasury Board is responsible for establishing and reviewing the Policy. Departments and the Treasury Board Secretariat share the responsibility for monitoring its application by departments and for taking corrective action within their own area of responsibility. Clearly, the well–managed work force adjustment situations cited by the Auditor General show that this system can and does work.*

Managing work force adjustments and the provision for payments in lieu requires the concerted effort of many players.

A need to ensure that all players work in partnership

7.73 Managing work force adjustment situations and the provision for payments in lieu requires the concerted effort of many players, including those in the Secretariat, the Public Service Commission, Supply and Services; and in departments, from deputy heads to managers to pay clerks. For example, if a pay clerk is not informed of the appropriate coding for payments in lieu, the deputy head and the Secretariat will not have the accurate information needed for monitoring payments. Who is responsible for providing leadership and ensuring that the respective roles, responsibilities and accountabilities are understood by all players; that the process is co–ordinated; that problems are identified; and that the concerns of each player are promptly addressed?

Treasury Board Secretariat's comments: *Implementation of the revised Work Force Adjustment Directive will be fully monitored, including through the internal audit activities of departments. Treasury Board Secretariat will work with heads of personnel, the Department of Supply and Services, and the Public Service Commission to ensure that the related data systems operate effectively. During 1993, there will be on–site reviews of work force adjustment documentation to verify that the provisions of the Policy are being properly interpreted and administered.*

True empowerment means that managers with delegated authority are provided with the information, the tools, the training and the support they need to exercise their authority.

A need to change the mindset about empowerment, control and accountability

7.74 In our opinion, there is also a need for a change in mindset about empowerment, control and accountability. During our audit it became evident that some managers were reluctant to interfere in the decision–making process of subordinates and adopted a hands–off attitude even when they were uncomfortable with a decision concerning a payment in lieu.

7.75 Empowerment is not the abdication of responsibilities. Nor is it simply the delegation of authority. True empowerment means that managers with delegated authority are provided with the information, the tools, the training and the support they need to achieve desired results. We found that while some managers had authority, they did not always have all of the necessary information and support needed to appropriately exercise that authority or to gradually improve their practices. For example, some managers were not aware of the staffing requirements in other parts of their organization that would have permitted them to manage work force adjustments better.

7.76 Management controls such as reviews, audits and reports should not always be seen as unnecessary constraints. When properly designed and used, these tools can contribute to improvement in practices over time and to the achievement of objectives.

7.77 There is also a need to move from an attitude that accountability rests only with those having the direct authority for making decisions to one where people concerned about a situation feel that they have a collective responsibility for probity and prudence. In the course of our audit, some people expressed concerns about the use of payments in lieu but did not feel that they had a responsibility to speak up. What information, tools, support and control mechanisms need to be provided by central agencies and departments to ensure that managers meet the government's objectives of reducing costs and properly managing the provisions of the Policy? How do we bring about the desirable attitudinal change?

***Treasury Board Secretariat's comments:** In the final analysis, the Policy will be well managed across the Public Service when both its intent and its letter are fully understood and accepted. This is a shared management responsibility of central agencies and departments.*

A need to determine more precisely when a genuine surplus situation exists

7.78 Payment in lieu was an option initially introduced to reduce the burden of redeployment after the government had announced its five–year, 15,000 person–year reduction program. It was a specific response to a specific situation. It is now a permanent feature of the Work Force Adjustment Policy. This implies that if an employee is declared surplus, that employee can request and — if conditions are met — obtain a payment in lieu and other benefits. Therefore it becomes critical to determine if a genuine surplus situation exists.

7.79 The use of the payment in lieu option may be justified in situations potentially affecting a large number of employees — such as contracting out, devolution to other levels of government or the relocation of work units. In other situations, however, such as a reduction of one or two percent in person–years, natural attrition and a slow–down or freeze on recruitment could be sufficient. There should be no need for managers to invoke a work force adjustment situation under the Policy and to use payments in lieu where good management practices would suffice.

There should be no need for managers to invoke a work force adjustment situation under the Policy and to use payments in lieu where good management practices would suffice.

7.80 Companies in the private sector that have successfully downsized have often used financial incentives. However, these incentives were offered only if the reduction sought was significant and if natural attrition would not be sufficient; they were tailored to fit the needs of the organization and were offered for a limited period of time — a window — before being withdrawn.

7.81 In the course of our audit, we noted that many employees who have received payments in lieu were in occupational groups where there is a continuous demand, such as clerks, secretaries and other support personnel, program administrators or even experts such as computer science specialists. We also noted that some 800 persons who received payments have been back on the payroll at some point in time. The public service hires some 5,000 indeterminate and more than 18,000 term employees every year; temporary agency personnel accounts for an equivalent of some 3,000 person–years annually; and there is an unknown number of individuals working under personnel services contract. How do we ensure the most economical and effective use of these various categories of human resources? When and in what circumstances is there a genuine need to invoke the Policy and the use of payments in lieu? Should payment in lieu be granted when there are suitable employment opportunities in other departments or agencies? If not, what mechanisms should be in place?

7.82 We are concerned that if payments in lieu are routinely used, the perceptions that they are an entitlement or a "right" regardless of circumstances will increase even further. This could have a long–term effect on natural attrition because of anticipation of future inducements. During our interviews, many employees said: "I hope that this program will still exist when I retire." Exhibit 7.13 shows that in 1991, payments in lieu represented a somewhat larger percentage of the separations of indeterminate employees from the public service than in

During our interviews, many employees said: "I hope that this program will still exist when I retire."

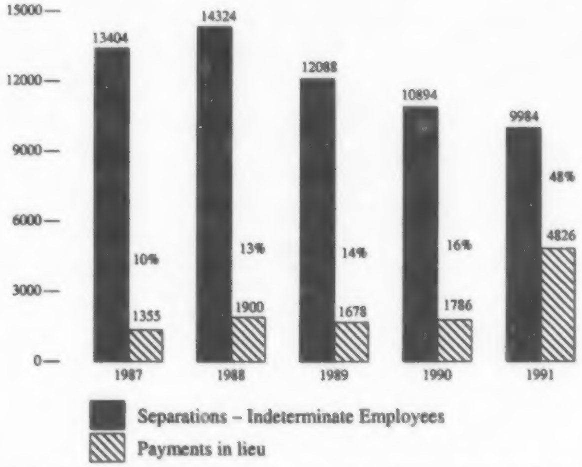
1987. We found, however, that the number of separations derived from the pay system and reported by the Public Service Commission for 1991 and previous years were significantly understated. How many people paid to retire or leave in 1991 would have left anyway? How many people are delaying retirement or resignation in anticipation of being in a position to request payments in lieu in the future? What measures should be in place to ensure that the public service has an appropriate separation rate in the context of long–term financial constraints and continuous work force adjustments?

A need to determine if other policies or other mechanisms should be available for application in certain situations

7.83 As mentioned in paragraph 7.56 and described in Cases 3 and 4 (see Exhibits 7.10 and 7.11), in a number of instances, managers have used payments in lieu for work force renewal or for solving performance or other personnel problems. Many felt that payments in lieu were an appropriate and humane way to resolve some of these problems, notably because no other policy or mechanism permitted the negotiation of the terms of the termination of employment in such situations. They were aware, however, that this was not the objective or intent of the Policy.

Exhibit 7.13

Relationship Between Separations* from the Public Service (Indeterminate Employees) and Payments in Lieu



Note: Graph based on payments for which information required for analysis was available.

* The number of separations excludes layoffs.

Source: *Public Service Commission reports (Separations – indeterminate employees)*
Departmental reports to OAG (payment in lieu)

7.84 While we sympathize with managers faced with such problems, we have concerns about using the provisions of the Policy to resolve them. There are many reasons for this, including the following:

- The Policy was not established for these purposes.
- All benefits flowing from the application of the Policy automatically "kick in".
- In many instances, management incurs additional costs to have someone perform the duties of the person who has left.
- The lack of consistency in approach could lead to labour relations problems and litigation.
- The use of payments in lieu in such situations can affect the morale of those remaining on the job.

7.85 Private sector companies have different policies to meet different needs. For example, they use financial incentives to negotiate the termination of employment of persons with performance problems, notably to avoid litigation. In such situations, however, the incentives are less generous than those used when the termination is due to lack of work or discontinuance of a function. The use of such incentives is tightly controlled to prevent abuse and to ensure consistency, fairness and equity. Similarly, companies offer different benefit packages to employees "volunteering", depending on whether they are already eligible for retirement, close to retirement or would welcome a change of career. Should there be other policies or mechanisms to deal with things other than lack of work or discontinuance of a function, such as work force renewal?

***Treasury Board Secretariat's comments:** Treasury Board Secretariat is reviewing whether additional policy tools are required to assist managers with work force renewal and other situations in which the Work Force Adjustment Policy was found to be applied inappropriately.*

A need to shift emphasis from reducing personnel to eliminating unnecessary or non–essential work

7.86 The emphasis that the government has placed on person–year reductions may have had important negative side–effects, including unintended reductions in levels of service or limits to management flexibility in making cost–effective decisions. Recent studies and surveys of downsizing practices and our own observations reveal that, while politically attractive, the first objective of downsizing should not be to eliminate workers or to reduce person–years. Instead, emphasis should be on the elimination of unnecessary, non–essential work or waste, improvements in decision making and the maintenance of or improvements in the levels of service at a lower cost over time.

A need to ensure that managers consider the full cost of their decisions

7.87 Central funding of payments in lieu using either departmental appropriations or Vote 5 — Government Contingencies — has also had significant side effects:

- It conveyed the paradoxical message that as long as person–years were reduced, cost–effectiveness was not important.
- It resulted in managers recommending or authorizing payments in lieu without being aware of the cost of their decisions.

As a result, managers made decisions regarding payments in lieu without concerns for cost–effectiveness. Would managers have reacted differently to requests for payments in lieu if they had known, and if their budgets had had to absorb, the full cost of their decisions?

Would managers have reacted differently to requests for payments in lieu if they had known, and if their budgets had had to absorb, the full cost of their decisions?

***Treasury Board Secretariat's comments:** Access was provided to Treasury Board Vote 5 to accommodate work force adjustment costs associated with the five–year person–year downsizing program announced in May 1985 Budget in situations where departmental appropriations were exhausted. Since the conclusion of the downsizing program in 1990–91 departments have been liable for all work force adjustment costs other than those arising directly from a Budget measure where permanent savings in salary costs are expected.*

7.88 In the context of PS 2000, the government has announced that, effective in 1993–94, all departments will have single operating budgets and that controls on person–years will no longer exist. The concept of the single operating budget implies that managers faced with the problem of having to reduce costs will have the flexibility to decide on the best alternative for achieving cost–savings. Our observations lead us to believe that this could be a move in the right direction, but that it may not be sufficient.

***Treasury Board Secretariat's comments:** The discipline embodied in the Operating Budget regime will reinforce the requirement that managers be accountable for the full financial consequences of their decisions, including those arising from the application of the Work Force Adjustment Directive.*

7.89 For expenditure reductions to be definitive and effective, the nature and level of services to be provided must be determined and the cost of providing these services must be calculated. Service level standards and the cost of providing these services must be used as the basis to "work smarter" to reduce costs while maintaining or improving the level of service over time. This requires that managers assume or consider the full cost of their decisions including payments in lieu. If it is not possible for a manager to assume the full cost of his/her decisions, the situation should be managed so that the costs not borne directly by the manager are fully considered in the decision–making process.

Treasury Board Secretariat's comments: *Errors have been made and the government is concerned about this. But with appropriate safeguards and encouragement of responsible action by its managers, the government is convinced that the policy of delegating to departments responsibility for administering the work force adjustment provisions is the best approach.*

9

Chapter 8

Search and Rescue

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Search and Rescue

Assistant Auditor General: Len McGimpsey
Responsible Auditor: Doug Timmins

Main Points

8.1 "Search and rescue" involves looking for and aiding people in distress. Although individuals are primarily responsible for their own safety, all levels of government, as well as members of the public, respond when people are in distress.

8.2 The times and locations of distress situations are not predictable, and no amount of resources can guarantee that all people will be saved. The federal government has located search and rescue resources at selected sites to respond to marine incidents in international and coastal waters and to air incidents. Other federal and non–federal resources are expected to, and do, respond to incidents in other areas. For air and marine incidents that are a federal responsibility, the federal government co–ordinates the response of all available resources.

8.3 Timeliness of response, which usually depends on the proximity of rescue resources to incidents, is a critical factor in saving people in distress. Our review of the reported air and marine distress incidents for 1989 and 1990 noted that even in areas where federal search and rescue resources were available, other resources often performed the rescue because they were closer to the scene.

8.4 The federal search and rescue system provides a reasonable response delivered by limited federal resources, volunteer groups and other resources. Federal resources play a key role in co–ordinating the response in air and marine incidents, but our analysis of distress incidents shows that federal search and rescue vessels and aircraft were instrumental in incident resolution less than 20 percent of the time. The search and rescue vessels of the Canadian Coast Guard played a key role in 12 percent of the reported marine distress incidents. The search and rescue aircraft of the Canadian Forces played a key role in 26 percent of the air and 3 percent of the marine distress incidents reported.

8.5 The requirement for federal search and rescue resources has the potential to be reduced by expanding the use of other federal and non–federal resources, such as the Canadian Marine Rescue Auxiliary.

8.6 Search and rescue patrol vessels often provide towing service to vessels requiring assistance. They provided critical assistance to a distress incident in the offshore area in one case. It should be possible to ensure that virtually the same extent of response for such incidents would be maintained by using other government vessels and vessels of opportunity, which are required to respond to distress incidents.

8.7 Information necessary to determine the need for search and rescue resources and alternatives for providing search and rescue services is incomplete.

8.8 Service standards, specifying a standard timeframe for resources to reach the incident site, have not been developed. Performance in relation to such standards should be used to assess the appropriateness of the location and extent of resources and, where applicable, the need to change the standards.

Introduction

8.9 "Search and rescue", as defined by the federal government, "comprises the search for and the provision of aid to persons, ships or other craft that are, or are feared to be, in distress or imminent danger." Search and rescue activities also include efforts to prevent the occurrence of such events.

8.10 Canada's population is widely dispersed throughout its vast, rugged and varied terrain. The coasts are exposed to the full effect of storms off the Atlantic, Pacific and Arctic Oceans, and our inland bodies of water are among the largest in the world. The Canadian Rockies and Canadian Shield overlie much of the land mass. Our weather involves extreme cold in winter and significant levels of annual precipitation, often aggravated by wind, fog, fire and avalanche conditions. It is not surprising that incidents occur that require search and rescue operations.

8.11 Individuals are primarily responsible for their own safety and for not endangering others. Nevertheless, when dangerous and life–threatening situations arise, assistance is often required. In many cases, private citizens provide assistance. All levels of government also maintain resources to be able to respond to people in distress.

8.12 Provincial, territorial and municipal governments, usually through their police forces, are responsible for the search for and rescue of persons who are missing or in distress on land or inland waters.

8.13 The federal government has established a program to provide search and rescue services to:

- aircraft using Canadian airspace and part of the international airspace over the Atlantic and Pacific oceans as specified in the Convention on International Civil Aviation;
- vessels using the Canadian waters of the Great Lakes, the St. Lawrence River and the Canadian waters, and parts of the international waters, of the Atlantic, Pacific and Arctic oceans as specified in the International Conventions for Safety of Life at Sea, on the High Seas, and on Maritime Search and Rescue; and
- users of our national parks.

8.14 The search and rescue activities of the federal, provincial, territorial and municipal governments are referred to in the Department of National Defence Part III of the Estimates as the National Search and Rescue Program. The objective of the program is to save lives by enhancing search and rescue prevention and the provision throughout Canada's accepted area of responsibility of effective and affordable search and rescue services. In providing search and rescue services to marine and air incidents, federal resources are assisted by volunteers, the private sector and other levels of government. In the context of the above, the objective of the federal element is to prevent loss of life and injury through search and rescue alerting, responding and aiding activities, which use public and private resources, including, where possible and directly related thereto, reasonable efforts to minimize damage or loss of property; and by ensuring appropriate priority to aviation and marine safety measures focussed on owners and operators most commonly involved in search and rescue incidents.

Individuals are primarily responsible for their own safety.

Background

8.15 The Department of National Defence (DND) co–ordinates federal search and rescue activities through Rescue Co–ordination Centres located in Halifax, Trenton, Edmonton, and Victoria. In addition, the Department provides 11 fixed–wing aircraft and 13 helicopters, which are primarily used for response to air and marine search

Exhibit 8.1

1992 DND Primary Search and Rescue Aircraft by Region

AIRCRAFT TYPE	VICTORIA	EDMONTON	TRENTON	HALIFAX	TOTALS
Labrador Helicopters	4* 		3 	6 	13
Hercules Fixed–wing		1 	1 *** 	2 ** 	4
Buffalo Fixed–wing	4 				4
Twin Otter Fixed–wing		3 			3
	8	4	4	8	24
1990–91 Operating Costs	$ 29.5 million	$ 12.4 million	$ 23.4 million	$ 31.4 million	$ 96.7 million
Replacement **** Cost	$ 380 million	$ 40 million	$ 220 million	$ 440 million	$ 1.1 billion
1990 Operation Hours	1,750	762	1,264	1,996	5,772
1990 Training Hours	2,581	1,316	2,132	2,961	8,990

* *A Labrador helicopter in Victoria was lost in a crash in 1992*

** *4 Buffaloes in Halifax have recently been replaced by 2 Hercules*

*** *6 Buffaloes in Trenton have recently been replaced by 1 Hercules*

**** *Based on planned replacements with new aircraft and including five helicopters in Victoria* and rescue incidents (see Exhibit 8.1). These resources are established and equipped for search and rescue operations and manned by search and rescue trained crews. Other DND air and marine resources are secondary search and rescue resources, which respond to search and rescue non–distress incidents when available and distress incidents when required.

8.16 The Department of Transport provides an air and a marine communications network to detect distress radio signals and to provide a communications capability for safety, search and rescue and other purposes with aircraft and vessels at sea. The Canadian Coast Guard (CCG) also provides primary marine search and rescue response through a fleet of 42 search and rescue vessels and 27 seasonal inshore rescue boats (see Exhibit 8.2). The balance of its fleet of vessels and aircraft is involved in search and rescue as a secondary role. The Coast Guard also operates the marine rescue sub–centres in Quebec City and St. John's, Newfoundland, and provides marine controllers at three of the Rescue Co-ordination Centres. The Coast Guard controllers are primarily involved in co–ordinating marine search and rescue response.

8.17 These arrangements enable Canada to fulfil its air and marine search and rescue obligations under international conventions to:

- monitor air and marine distress calling frequencies for distress calls and provide the capability to conduct safety and search and rescue communications;
- arrange for the establishment and provision of 24–hour search and rescue services to specific areas;
- co–ordinate and arrange for provision of adequate search and rescue services around the sea coast;
- designate, as rescue units, elements of public or private services suitably located and equipped for search and rescue; and
- abide by other international standards and recommended practices in the provision of search and rescue services for aircraft and vessels.

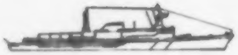
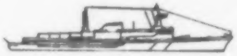
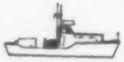
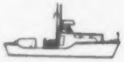
8.18 A "search and rescue incident" is recorded when the federal resources in the search and rescue system are alerted. An incident is classified as a "distress incident" when there is reasonable certainty of people being in imminent danger and requiring immediate assistance. There were 1,800 air search and rescue incidents recorded in 1989 and 1990. Of these, 326 were recorded by the Rescue Co–ordination Centres as distress incidents. There were 14,361 marine search and rescue incidents recorded over the same period. Of these, 1,594 were recorded by the Rescue Co–ordination Centres as distress incidents.

In search and rescue, federal resources are assisted by volunteers, the private sector and other levels of government.

8.19 In addition to the Department of National Defence and the Canadian Coast Guard, volunteers, commercial operators, members of the public and other levels of government and federal departments, all make a contribution in the provision of search and rescue. One organization that is involved in many of these distress and non–distress incidents is the Canadian Marine Rescue Auxiliary (CMRA). Under Canadian Coast Guard direction, the Auxiliary was established in 1979 to provide co–ordinated volunteer assistance in marine search and rescue incidents, particularly where Canadian Coast Guard vessels were not in proximity, and to aid in the prevention of incidents. The CMRA participated in 3,762 incidents, distress and non–distress, in 1989 and 1990. More recently, in 1986, the Civil Air Search and Rescue Association was formed to provide similar co–ordinated volunteer assistance related to air incidents. Further, 14 Department of Fisheries and Oceans vessels provide support to the search and rescue program as a secondary role. In the fiscal year

Exhibit 8.2

1992 CCG Primary Search and Rescue Vessels by Region

VESSEL TYPE	VICTORIA	EDMONTON	TRENTON	HALIFAX	TOTALS
600, 500	2 			3 	5
400, 300, 200, 100	8 	1 	9 	16 	34
Hovercraft	3 				3
Inshore Rescue Boats	4 	1 	6 	16 	27
	17	2	15	35	69
1990–91 Operating Costs	$ 10.9 million	$ 0.8 million	$ 3.5 million	$ 28.5 million	$ 43.7 million
Replacement ** Cost	$ 155.1 million	$ 1.4 million	$ 28.4 million	$ 360 million	$ 544.9 million
1990–91 Operation Hours*	2,602	132	1,236	5,945	9,915
1990–91 Training Hours*	957	6	124	1,154	2,241

* *Hours do not include time for inshore rescue boats*

** *Includes $185 million for the equivalent costs for patrol vessels, where such vessels have been decomissioned and patrolling operations have been continued through other coast guard vessels*

1989–90, these vessels were involved in 184 incidents, while the remainder of its fleet was involved in an additional 115 incidents.

8.20 The federal search and rescue system has been developed over the years to deal with Canada's large area of search and rescue responsibility. A reasonable response is provided through limited federal resources, assisted by volunteer groups developed over the years and by other resources. In comparison, the United States has normally less severe weather conditions, more federal resources available and less volunteer involvement.

8.21 The main users of federal search and rescue resources are people engaged in marine and air activities, such as recreational boating or flying and commercial shipping or fishing. There are currently more than two million recreational boats, 20,000 registered fishing vessels and 7,760 registered commercial shipping vessels in Canada, a significant portion of which are in waters served by the federal government. In addition, there are approximately 28,000 aircraft, including 1,440 helicopters, registered in Canada. The large number of foreign vessels and aircraft that travel through Canada's area of responsibility also rely on the Canadian search and rescue system.

8.22 The operating expenditures for federal search and rescue activities are about $200 million annually, the majority of which is to provide federal primary search and rescue resources. Total federal search and rescue resources have a replacement value of more than $1.5 billion, about $1 billion for the Department of National Defence and about $360 million for the Canadian Coast Guard, which excludes $185 million for the equivalent cost of patrol vessels where such vessels have been decommissioned and patrolling operations have been continued through other Canadian Coast Guard vessels.

8.23 The federal search and rescue resources also respond to requests for humanitarian aid or assistance to civil authorities. Most of the 1,564 such incidents in 1989 and 1990 were the responsibility of provincial and local authorities. However, some involved the evacuation of people from vessels because of medical emergencies. Although these incidents did not involve searches, federal resources were expected to, and did, respond to these incidents, which are considered distresses under international convention. Federal search and rescue resources, mainly helicopters, responded to 145 of these incidents. We have included the time spent on all these incidents in our review of the hours of utilization of federal search and rescue resources.

Audit Scope and Criteria

8.24 This audit focussed on the federal search and rescue activities, particularly the operation of federal resources used to aid people in distress. We also reviewed the management of the National Search and Rescue Program. Exhibit 8.3 shows the scope of our examination.

8.25 In carrying out our audit, we expected to find that the federal search and rescue program would be planned, controlled and monitored in such a manner as to contribute to the prevention of loss of life or injury. In this regard, we expected to find that search and rescue services were delivered with due regard to economy and efficiency.

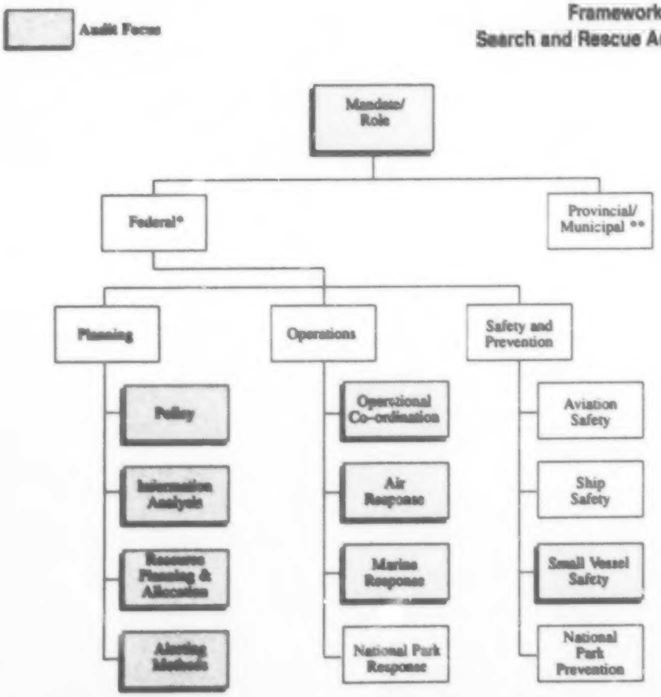
8.26 The provincial and municipal search and rescue activities were not audited, although their impact on federal activities was given consideration. The Royal Canadian Mounted Police were not audited because their search and rescue activities are generally carried out on behalf of provincial authorities. Activities in the national parks were also excluded because they are not a major portion of the federal expenditures.

8.27 For our review of search and rescue prevention activities, our focus was on the regulation, enforcement and promotion of safe operation for small vessels. Large commercial and fishing vessel safety, examined by our Office in 1989, and aviation safety were not reviewed in this audit.

8.28 The Department of National Defence helicopter replacement project, which was in the planning phase at the time of our audit, was reviewed in relation to its potential impact on federal search and rescue resources.

Exhibit 8.3

Framework for Search and Rescue Audit


Audit Focus
Mandate/ Role
Federal*
Provincial/ Municipal **
Planning
Operations
Safety and Prevention
Policy
Information Analysis
Resource Planning & Allocation
Alerting Methods
Operational Co-ordination
Air Response
Marine Response
National Park Response
Aviation Safety
Ship Safety
Small Vessel Safety
National Park Prevention

* responsible for search and rescue incidents involving people in aircraft, people in vessels in coastal and international waters, and users of national parks

** responsible for search and rescue incidents involving people in vessels in inland waters, swimmers and missing persons on land

Observations

Previously Proposed Solutions Have Not Been Fully Implemented

Significant elements of a National Search and Rescue Program have not been developed

8.29 There have been several studies on the organization, mandate and interdepartmental co-ordination of federal search and rescue activities. These studies include the 1976 Report to the Treasury Board on the Interdepartmental Review of Marine Search and Rescue, the 1982 Report to the Cabinet on an Evaluation of Search and Rescue and the 1985 Report of the Royal Commission on the Ocean Ranger Marine Disaster. These reports made numerous detailed recommendations to improve the management of and accountability for search and rescue. As an overall solution, both the 1982 Evaluation and the 1985 Royal Commission reports recommended the establishment of a National Search and Rescue Program with roles for federal, provincial and local authorities and participation by the private sector and members of the public, and the creation of an organization, independent of the delivery departments, to design and manage this program.

8.30 In 1986, the Minister of National Defence was reaffirmed as having authority and accountability for the co-ordination of the National Search and Rescue Program. The National Search and Rescue Secretariat was given responsibility for the development of the program. Delivery departments, in particular the Department of National Defence and the Canadian Coast Guard, were to be accountable for the delivery of the federal element of the program in accordance with approved levels of service.

8.31 Volunteers and other levels of government do participate in search and rescue activities. Nevertheless, to fully implement a National Search and Rescue Program, as endorsed by Cabinet, other levels of government need to be more fully integrated into the program. Other aspects of the program not yet implemented include agreement on a national policy, a management information system, and service standards needed for effective management.

To fully implement a National Search and Rescue Program, other levels of government need to be more fully integrated into the program.

8.32 The Royal Commission on the Ocean Ranger Marine Disaster identified the principal approaches for providing search and rescue services. These approaches range from a "dedicated rescue service", which would require full support by federal resources, to "response when all else fails", which might not require any federal search and rescue resources. The appropriate approach within this range has not yet been clearly identified as a basis for determining the required level of federal search and rescue resources.

8.33 Major computer-based projects for policy research and for operational and management information, costing more than $4 million, have not been successfully implemented. A level of service initiative has been underway for several years, but no agreement has been reached on ways of measuring levels of service, let alone the standards or targets that should be achieved.

8.34 Although the federal government is expected to respond to people in distress, it does not, and could not be expected to, provide all search and rescue response. Volunteers, the public, or provincial or other jurisdictions are expected to, and often do, provide the resources necessary to carry out a rescue. Our review has indicated that although the federal search and rescue resources were often called upon first in search and rescue incidents, they did not carry out the actual rescue for most distress incidents, because other resources closer to the scene were able to.

8.35 The recommendations of the 1982 Evaluation of Search and Rescue and the Royal Commission on the Ocean Ranger Marine Disaster, as well as subsequent directions arising from these reports, directed federal search and rescue activities towards greater integration, more extensive management planning, more examination of trade-offs and increased prevention efforts. Some of these recommendations and policy directions have not been achieved to date. As a result, opportunities still exist to deliver search and rescue more economically and efficiently through the greater use of volunteers and other resources and through more use of other federal resources. These opportunities warrant further consideration.

8.36 Despite efforts and recent agreement on the roles and responsibilities of federal participants, much more needs to be done in the development of the National Search and Rescue Program. A truly national program would rely on a combination of federal and other resources in program delivery. The provincial and other jurisdictions responsible for land and inland water search and rescue services would have to play a significant role in the development and delivery of a national program. In view of the lack of progress, legislation may be required to set out the objectives and principles of the program and to provide for the establishment of arrangements with provincial and other jurisdictions as to responsibility for providing search and rescue resources. To be effective, the program requires a process that would facilitate and encourage the co-operation and co-ordination of all participants.

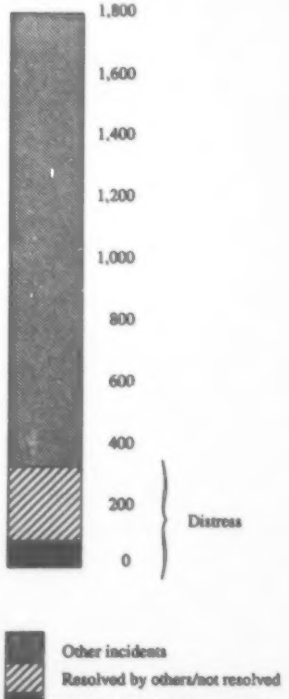
8.37 All departments and agencies involved in search and rescue should accelerate efforts to reach agreement on the principles of the National Search and Rescue Pro-

gram and should develop applicable legislation, if required.

Interdepartmental response: *The federal participants with responsibilities for search and rescue have agreed on the objectives and principles of the National Search and Rescue Program as published in the National Search and Rescue Program Concept, which was approved by the Interdepartmental Committee on Search and Rescue (ICSAR) on 17 October 1991 and signed by the Lead Minister for Search and Rescue on 25 February 1992, and on the federal search and rescue activities as stated in the Roles and Responsibilities Documents approved by the Interdepartmental Committee on Search and Rescue on 9 April 1992. Development of applicable legislation is not required at this time.*

Exhibit 8.4

1989 and 1990 Air Incidents



Service standards are lacking

8.38 One of the major recommendations of previous studies concerned the development of service standards. Service standards should be based on need and indicate the extent to which available resources should be able to respond to incidents and provide assistance within a specified period of time. The 1982 Evaluation of Search and Rescue stated that there was no policy on required service standards for search and rescue in Canada and that standards would be valuable for determining resource needs, showing the public the amount of self–help expected and providing the basis for performance measurement. The Royal Commission on the Ocean Ranger Marine Disaster also identified service standards as a key accountability tool for delivery departments.

8.39 The Canadian Coast Guard monitors performance against effectiveness goals that state, depending on the severity of the incident, a percentage of lives that are expected to be saved. Neither the Coast Guard nor DND have established service standards that cover all the time elements of search and rescue response. Both have established a standard for the readiness time element only. DND search and rescue aircraft are expected to be able to take off within 30 minutes of notification during normal working hours and two hours otherwise. The Coast Guard search and rescue vessels are expected to be able to get underway within 30 minutes of notification when on stand–by.

8.40 Service standards need to be developed, taking into account such factors as transit time, weather, severity of incident (distress or non–distress), need for search, and speed of notification. Changes in the average number of distress incidents in a location could also be a factor in establishing service standards. For less populated areas, where there are fewer incidents, federal search and rescue resources are not nearby, and thus the response time from these resources would be longer. Other resources often perform rescues in these locations. As a result, and given that operators of aircraft and vessels have the basic responsibility for carrying out their own activities safely, federal search and rescue resources should not be expected to be available to meet all needs.

8.41 The United States Coast Guard has established a standard for federal resources to arrive at the scene within two hours of notification of an incident. The two–hour timeframe includes time for getting ready, travelling to the area and locating the scene. Adherence to this standard is monitored. The standard response time would not necessarily be the same in Canada because of differences in availability of resources, weather and distances to be covered. Nevertheless, the United States example indicates that service standards can be established.

8.42 Each of the delivery departments should establish and use search and rescue service standards to:

(a) plan for resources;

(b) monitor the use of and need for resources; and

(c) indicate to the public the response standards to be expected of search and rescue resources.

Interdepartmental response: *It is agreed that service standards capable of addressing the recommendation are required and both CCG and DND have developed service standards which satisfy their individual requirements. Departmental statements differ because of the inherent differences between air and marine search and rescue incidents, response requirements and geographical factors. DND and CCG remain unconvinced that time–based service standards as envisaged by the OAG would be beneficial or practical, as they do not provide a true indication of the search and rescue program's effectiveness.*

Opportunities Exist to Improve Program Delivery

Federal search and rescue resources do not perform the rescue in most distress incidents

8.43 Out of the 1,800 air incidents to which the federal search and rescue service was alerted in 1989 and 1990, the Rescue Co–ordination Centres recorded 326 as distresses (see Exhibit 8.4). Our analysis indicated that federal primary search and rescue resources played a critical role in locating or rescuing in 86 of these distress incidents. It also indicated that the search and rescue technicians and the specialized equipment carried by these resources, such as hoists and survival kits, were used in 37 distress incidents.

8.44 Of the 14,361 marine incidents to which the federal search and rescue service was alerted in 1989 and 1990, 1,594 were recorded as distresses (see Exhibit 8.5). We examined the 916 of these marine distress incidents that involved federal search and rescue resources, and our analysis indicated that the Canadian Coast Guard resources played a critical role in locating or rescuing in 187 of these incidents. The Department of National Defence resources played a critical role in locating or rescuing in 48 marine distress incidents; they used specialized equipment in 23 of these. Search and rescue resources often participate in a search, even though they may not locate the scene or may not perform the rescue. This may be due to the nature of the incident or because others performed the rescue. In some cases, the federal search and rescue resources provided on–scene co–ordination of all the other resources participating in the search.

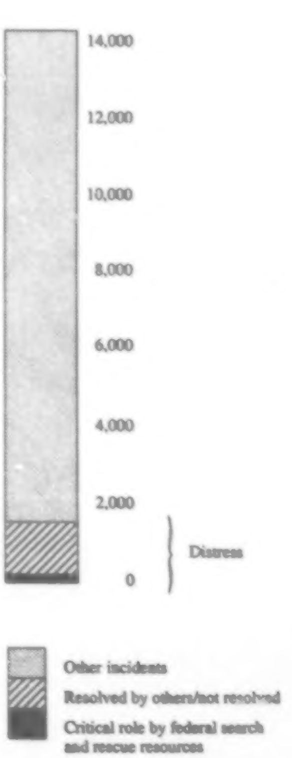
8.45 Our analyses were based only on the distress incidents to which the Rescue Co–ordination Centres were alerted. However, there are many distress situations to which they do not get alerted. Many air and marine accidents reported to the Canadian Transportation Accident Investigation and Safety Board (CTAISB) were of a nature similar to distress incidents, but federal search and rescue resources were not alerted. Any response necessary in these air and marine accidents was provided by other resources.

Expanded use of volunteer and other resources should be pursued

8.46 Although all incidents, distress or non–distress, need to be resolved, not all require response. When response is required, proximity of resources to the scene is critical to saving people in distress. Current federal primary search and rescue resources are not able to provide a timely response in all distress situations. In 1989 and 1990, volunteer and other federal and non–federal resources played a critical role in five out of six marine distress incidents, often because of their proximity. In a country as vast as Canada, with the large number of incidents requiring response, the expanded use of such other resources could reduce the demand on and re-

Exhibit 8.5

1989 and 1990 Marine Incidents



quirement for federal search and rescue resources.

8.47 With the assistance of the Canadian Coast Guard, the involvement of the Canadian Marine Rescue Auxiliary in search and rescue activities has grown, since its inception in 1979, to the point where the Auxiliary is now participating in about 25 percent of the marine incidents. The Coast Guard has, in a few locations, established the practice of loaning vessels to the Auxiliary for search and rescue service. Although it will take time and planning, there is the potential to expand the Auxiliary's role by increasing the reliance on volunteers and the number of loaned vessels.

Volunteer and other resources played a critical role in five out of six marine distress incidents.

8.48 Recent Coast Guard search and rescue capital resourcing decisions have not taken into consideration the availability of other resources such as the Auxiliary. For example, the information submitted regarding the decision to replace 15 lifeboats made no reference to the availability of other resources. Nor did this submission assess the continuing need for some of those lifeboats, which had not played a critical role in any distress incidents in recent years. Our analysis indicated that 4 of these 15 lifeboats had not performed the rescue in any distress incidents for 1989 and 1990. In addition, in one of the communities where a lifeboat replacement was planned, there were already several Auxiliary vessels and a police vessel. Also, the fire department planned to acquire a hovercraft. Further, there was only one distress incident in which this lifeboat performed the rescue for 1989 and 1990.

8.49 The Civil Air Search and Rescue Association (CASARA) was established in 1986 to provide co–ordinated volunteer assistance in searching and to aid in the prevention of air incidents. The volunteers of the Association participated 298 times in incidents in 1989 and 1990. DND has stated that there is potential for having more fixed–wing search activities conducted by CASARA. The Department needs to develop, in conjunction with the Association, a plan to ensure that this potential is achieved.

8.50 Other volunteer groups that have been set up to assist in searches on land or inland waters have been used in air and marine incidents under federal jurisdiction. There may be opportunities to rely more on these groups in the future. In addition, there are opportunities to rely more on chartered helicopters in search and rescue operations.

8.51 The Canadian Coast Guard and the Department of National Defence should continue to pursue the opportunities to increase the use of volunteers and other resources in search and rescue activities.

DND response: *DND is extremely pleased with the development of the Civil Air Search and Rescue Association (CASARA). Canadian Forces search and rescue officials will continue to work closely with CASARA executives to achieve the full potential of the volunteer contribution to the Canadian search and rescue service.*

Canadian Coast Guard response: *Agreed. The Canadian Coast Guard will continue to support the use of volunteers in search and rescue activities, while keeping in mind the importance of adequate training and procedures.*

The provision of search and rescue service with patrol vessels requires re–examination

8.52 Even with appropriate survival equipment, the typical limit of life expectancy in the vast majority of search and rescue incidents is less than six hours. Search and rescue patrol vessels (Types 600 and 500) can reach any location within an area of approximately 25,000 square miles in a six–hour period. Canada is responsible for providing marine search and rescue services over hundreds of thousands of square miles of ocean. The combined coverage of the search and rescue patrol vessels is only a small fraction of this and, in effect, only provides a few additional vessels at sea that may or may not be close enough to respond in time.

8.53 The 1989 National Search and Rescue Secretariat offshore study noted that the Type 600 vessels had not been critical to saving any lives during the period 1983 to 1987. A 1992 Department of Transport program evaluation of search and rescue indicated that the costs of providing these vessels exceeded the benefit provided.

8.54 Our analysis indicated that the eight patrol vessels in service in 1989 and 1990 played a critical role in one distress incident offshore, although other resources were on–scene at the time. The patrol vessels did play a critical role in a number of incidents inshore during this period. In practice, patrol vessels perform as any other vessel at sea, in that they respond and play a critical role in distress incidents only when they are the closest resource. The patrol vessels were also used to respond to non–distress incidents, some of which the Coast Guard judged to have the potential to deteriorate into a distress situation if assistance were not provided. For the years under review, incidents of this type were not distinguished from other non–distresses. A revision to the classification of incidents is currently under way to provide this distinction.

8.55 The Coast Guard has implemented an overall fleet restructuring, which has reduced the size of the fleet. As part of this restructuring, the Coast Guard recently decommissioned two search and rescue patrol vessels and plans to decommission one of the five remaining patrol vessels. Search and rescue services in the ocean have remained unaffected, since other vessels from the overall fleet now carry out search and rescue patrols on a rotational basis.

8.56 If there were no search and rescue patrol vessels, distress situations would continue to be handled by aircraft as well as other government and non–government vessels which, in accordance with the "law of the sea", must respond to such incidents. It would be necessary to assess the risk of search and rescue incidents in particular areas at certain times of the year and to develop a plan to ensure that resources would be available if and when needed. For potential distress and other non–distress incidents, other government vessels should be able to provide the response required, since the nature of these situations normally does not call for as urgent a response. This would require some change in the current approach in order that other government vessels would respond to potential distresses on a priority basis when deemed appropriate.

The appropriateness of discontinuing search and rescue patrols should be considered.

8.57 **The Canadian Coast Guard should consider the appropriateness of decommissioning all search and rescue patrol vessels and discontinuing search and rescue patrols.**

Canadian Coast Guard response: *Agreed. However, caution must be exercised so as not to jeopardize the effectiveness of the search and rescue*

Search and rescue patrol vessel (see paragraph 8.52).

Two helicopters meet the majority of the training allocation and operational requirements.

response and the Coast Guard's capabilities in other program areas such as pollution response, which these units also support. It must also be noted that search and rescue missions are inherently dangerous, and the right capability in both people and equipment has a direct impact on distress resolution and saving life.

More use of other federal resources for search and rescue is possible

8.58 The Department of National Defence currently uses its fleet of Hercules fixed–wing aircraft in Edmonton to carry out search and rescue as well as air transport operations. One of the 14 Hercules aircraft is available for search and rescue on a continuous basis. This provides the advantage that fewer primary search and rescue aircraft are needed because back–up services are provided through the larger aircraft fleet. A similar approach has recently been adopted with Hercules fixed–wing aircraft in Trenton. The number of primary search and rescue fixed–wing aircraft have been reviewed, and a plan is being implemented to reduce them from 18 to 6.

A Labrador helicopter used in search and rescue (see paragraph 8.59).

8.59 There are a number of military helicopters assigned primarily to meet search and rescue operational and training requirements. At the time of our review, there were two Labrador helicopters in Comox used primarily for initial air crew training. Three Labradors were located at each of Comox, Trenton, Greenwood and Gander for search and rescue operations. On average, each operations helicopter flew 165 hours per year for search and rescue operations.

8.60 Two helicopters at each base meet the majority of the search and rescue training allocation and operational requirements. A review of DND's predicted availability data indicated that to achieve a high probability of having one available, a third helicopter could be required for backup in the event of maintenance on the first two helicopters, for 22 days or approximately 30 operational flying hours per year. This third helicopter also provides additional training hours. However, the number of training hours is not determined solely based on standards. A more precise system of scheduling training and a more rigorous review of training hours allocated might allow DND to reduce training requirements.

8.61 In addition to its primary search and rescue helicopters, the Department of National Defence has 173 other helicopters at 14 different locations, many of which may be able to be used more for search and rescue activities. These helicopters include 34 Sea Kings, 9 Iroquois and 44 Twin Huey helicopters, which, although seldom used for search and rescue, have performed rescues in the past. In Canada, the Sea King helicopter is primarily used for naval purposes, although this type of helicopter is used by other countries for search and rescue. The Iroquois and three of the Twin Huey helicopters are designated as base rescue helicopters. The need for search and rescue rotary–wing aircraft has been met in the Edmonton region using chartered and secondary military helicopters rather than a three–helicopter search and rescue squadron.

8.62 The Department of National Defence recently announced plans to replace its existing naval and search and rescue fleets by acquiring 35 new naval helicopters and 15 new search and rescue helicopters, at an estimated cost of about $4.4 billion. The naval helicopters are being acquired partly on the basis of their capability to carry out a support role in search and rescue. The Department also plans to acquire 100 utility helicopters for other military purposes. It would appear that more use of other military helicopters for search and rescue is possible. In particular, the new naval helicopters will be useful in responding to marine incidents and the utility helicopters can be used for inland incidents. This, in conjunction with a review of training requirements and of ways of meeting those requirements, may lead to opportunities to reduce the number of primary search and rescue helicopters.

8.63 We also identified opportunities for increased utilization of the Canadian Coast Guard fleet and of other federal fleets. Search and rescue vessels, on average, spend about three percent of their available time responding to search and rescue incidents. In some communities, other Coast Guard vessels could handle these operations. For example, in the Western Region, three replacement marine emergency vessels that are being acquired may be able, in conjunction with other vessels in the area, to take on search and rescue responsibilities. In the Maritimes region, marine emergency response and search and rescue operations have already been integrated.

8.64 Vessels of other departments could also be used more to provide search and rescue services. In certain locations, this could eliminate the need for some Canadian Coast Guard search and rescue vessels. For example, on the Great Lakes, two Department of Fisheries and Oceans hydrographic launches support search and rescue activities as a secondary role. Program commitments need to be taken into account; however, with more use of the additional hydrographic launches, it is possible that one Coast Guard search and rescue vessel valued at more than $3 million could be decommissioned or used for other purposes.

8.65 Resource–sharing arrangements could also be developed with provincial and municipal jurisdictions to permit further fleet rationalization.

8.66 The Department of National Defence and the Canadian Coast Guard should pursue the opportunities for increased use of other federal resources in providing search and rescue services.

DND response: *The recent Canadian Forces search and rescue fleet rationalization review identified the opportunity to reduce the size of the Canadian Forces fixed–wing fleet based on an increased role for CASARA and other federal resources as well as an expanded operational role for the new search and rescue helicopter. Functions such as the demanding mountain search role, currently assigned, for the most part, to fixed–wing aircraft, will be performed primarily by the new search and rescue helicopter in the future. With this expanded rotary–wing mandate, there is a clear operational need to have at least three search and rescue helicopters at each search and rescue squadron from which to draw resources for search and rescue operations.*

Owing to the demanding environment faced by operational search and rescue crews, training programs are carefully scrutinized and minimum training requirements are objectively established to ensure that all crew members are qualified and capable of operating safely. Should DND be able to reduce flying training hours in the future, the operational need for a *minimum core search and rescue helicopter fleet would still remain.*

Canadian Coast Guard response: *Agreed. The Department currently and actively pursues the use of other federal and non–federal resources.*

Performance information is lacking

8.67 Management needs performance information to make decisions on such matters as the resources required for service delivery, their location, the levels of service they can provide and the need for additional or better–focussed prevention efforts. Performance information should capture data necessary to manage the program, such as the nature of each incident, the time and type of response that resolved the incident, the location of the incident and the measurement of actual performance against service standards.

8.68 Previous studies have identified the need for better performance information. A joint DND/CCG team evaluating the search and rescue program concluded in 1980 that the existing statistics were inadequate to determine the need for search and rescue resources. The 1982 Evaluation of Search and Rescue identified problems in the definition and validity of data. It stated that there was no agreement among departments involved as to what information should be provided for performance measurement and program planning and that such agreement was required before an overall management information system could be developed.

8.69 In 1991, a $2–million effort to develop the Search and Rescue Information System (SARIS), a policy and operational information system started in 1986, was halted because a study of the project indicated that there was a lack of agreement and clarity in understanding the purpose of the system, a lack of procedures to ensure data integrity and inadequate system testing and training. A review is currently underway to determine if some of the operational information aspects of the system can be retained.

8.70 Throughout this period of system development, the Canadian Coast Guard maintained its incident data base. Although this system has weaknesses, it continues to be used because no other system is fully operational. A review of this system has recently been completed, and improvements are planned. Currently, only minimal performance information is available. Information is recorded on response times and on the use of resources in service delivery by location, resource type and incident type. Although analysis of needs and resource availability has been done, neither department uses the information for ongoing analysis of the impact on the levels of service to be provided or the need for or location of resources. Information is not recorded on the extent to which search and rescue resources are involved in incidents or are instrumental in rescuing people in distress.

8.71 Information on air and marine accidents is recorded by the Canadian Transportation Accident Investigation Safety Board. The aircraft accidents recorded by the Board often involve serious injury or loss of life.

8.72 We reviewed the aircraft accidents in Canada reported to the Board for 1989 and 1990 and found that just over half of the search and rescue air distress incidents were also recorded as aircraft accidents by the Board. We also noted that 852 aircraft accidents recorded by the Board did not involve federal search and rescue resources. Some of these accidents occurred at airports, and therefore search and rescue resources were not required or alerted. However, many others were of a nature similar to search and rescue distress incidents. For example, we noted that the search and rescue system was alerted in only 29 of 60 air accidents that involved serious injury or loss of life, even though all of them were reported as not happening at or near an airport.

8.73 The large number of accidents in which federal search and rescue resources were not involved may indicate the need for changes. A review of all aircraft accidents is required to determine how they were resolved without the involvement of federal search and rescue resources, why federal resources were not alerted and whether this indicates that changes are required in search and rescue services, equipment or the location of resources.

8.74 In our review of search and rescue incidents, we noted that most of the time, false alarms and mechanical breakdowns of vessels were recorded as non–distress incidents. However, some such incidents were recorded as distresses because at some point in responding it was determined that there was reasonable certainty of danger to life. Further categorization as to the severity of the incident and the type of assistance required would provide more meaningful information for decision making.

8.75 All departments involved in search and rescue should develop additional information required to:

(a) acquire resources economically;

(b) manage resources efficiently;

(c) make levels of service decisions; and

(d) measure performance.

Interdepartmental response: *Agreed. Search and rescue operating departments are enhancing current data–gathering systems and developing new ones, utilizing some aspects of the SARIS system, which will continue to satisfy the recommendation.*

Analysis of the causes of beacon failures and false alarms is required

8.76 Emergency beacons, which are designed to be activated automatically, transmit a distress signal. Satellites, aircraft and vessels use this signal to identify the site of an incident. The majority of aircraft and all vessels over 20 metres must carry such beacons. Our analysis shows that aircraft beacons were used to alert the Rescue Co–ordination Centre in 28 percent of the air distress incidents for 1989 and 1990.

8.77 Failure of the aircraft beacon to activate automatically has been a major issue since it was regulated into use in 1974. These beacon failures can result in extensive searches. For example, because of beacon failures, three large searches in British Columbia in 1990 required 1,590 hours of primary air resources. This is in comparison to the 874 total hours for 1989 spent by primary air search and rescue resources on all air distresses in Canada. Clearly, beacon failures can be costly, but what is more important, lives may not be saved.

8.78 Little information on aircraft beacon failures in Canada is available, but our analysis of 1989 and 1990 distress incidents revealed that beacons did not activate in 27 percent of the incidents involving crashes. Furthermore, we could not determine whether they activated in another 19 percent of such incidents. As a result, beacons may not have activated in up to 46 percent of the incidents involving crashes.

The problem of aircraft beacon failures exists throughout the world.

8.79 The problem of aircraft beacon failures exists throughout the world and has not yet been resolved. Studies have been carried out on beacon failures in the United States. Canada participated in the development of new technical design standards that were issued in 1985. Recently, the Department of Transport's Aviation Group started field–testing beacons manufactured to those standards. The Aviation Group expects to complete this testing in late 1993.

8.80 Emergency beacons also generate many false alarms. In 1989 and 1990, the Department of National Defence noted 932 beacon false alarms, mainly from aircraft beacons. Our analysis indicates a false alarm rate of 85 percent for beacon alerts. In 1990, federal search and rescue resources responded to 95 false alarms related to beacon alerts. In 1985, the Department of National Defence started testing a 406 Mhz beacon. The positive identification possible by such beacons should reduce the number of false alarms to which resources were responding. In the event of a false alarm, contact with the owner could eliminate the need to send a resource to the scene. At the present time, there is no requirement to carry this type of beacon in Canada or elsewhere.

Small boats accounted for more than 6 out of 10 of the marine distress incidents.

8.81 Beacons are the source of alert in air distresses much more often than in marine distresses. Our analysis indicates that only three marine distress calls in 1989 and 1990 came from a beacon alert. We found seven cases where beacons should have been on board, but were not used to signal the distress. During the same period, marine beacons generated 26 false alarms that resulted in the tasking of resources.

8.82 Ongoing analysis of the causes of aircraft and marine beacon failures and false alarms in Canada is not carried out. Such information would be useful in determining the need for further education of users, enforcement of regulations or changes to beacon specifications.

8.83 The Coast Guard is considering a revision to the beacon regulations that would require all commercial vessels over 12 metres to carry a beacon by 1995 and those over 8 metres by 1999. The total cost to commercial vessels, based on an estimated price of $1,500 each, would be approximately $30.5 million. The Coast Guard, in targeting these craft, will be affecting only a small percentage of the vessels in Canada. The benefit of this change in regulations has been identified as a reduction in search time and in lives lost, but no estimate of savings in search time has yet been made. Although no reasonable determination can be made of the number of lives that could have been saved by having beacons on more vessels, it is possible to estimate the number of cases where a beacon would have resulted in a faster alert. The potential for a much higher number of false alarms also needs to be taken into consideration.

8.84 The Department of Transport should ensure that information on the causes of beacon failures and false alarms is collected, analyzed and considered before taking action designed to address beacon failures.

Department's response: Agreed, and implementation ongoing.

Information is needed on small boat activities

8.85 The aviation community has extensive regulation and safety promotion. A pilot is required to have a licence to fly, and all aircraft must go through regular safety checks to remain certified. Commercial and large fishing vessels are also highly regulated. However, the over two million small boats, less than 15 tons or 20 metres, are not similarly regulated. Small boats accounted for more than 6 out of 10 of the marine distress incidents in 1989 and 1990.

8.86 There are federal Small Vessel and Small Fishing Vessel Regulations related to equipment standards, but there is no provision for federal enforcement of these regulations. There is some enforcement of the regulations by the Royal Canadian Mounted Police on behalf of provinces, and by regional, municipal and ports police under a variety of authorities.

8.87 The search and rescue prevention activities involve promotion and awareness of small boat safety. The Canadian Coast Guard is assisted in the delivery of its small boat safety awareness program by Canadian Marine Rescue Auxiliary members who are trained as prevention officers. There are opportunities to expand the use of these resources for prevention, as well as the volunteer air resources of the Civil Air Search and Rescue Association. In addition, the Canadian Red Cross, the Royal Canadian Mounted Police and other police forces participate in promotion and awareness. Other bodies such as the Canadian Power and Sail Squadrons deliver education programs.

8.88 Because the Department of Fisheries and Oceans is in regular contact with fishermen and issues licences to them, it could more actively participate in promotional and awareness aspects of search and rescue prevention activities. At the present time, there is no requirement for fishing vessels to demonstrate adherence to the Canada Shipping Act safety regulations prior to the granting of a licence. The Department of Fisheries and Oceans licensing process likely could be better co–ordinated with the inspection of fishing vessels by the Department of Transport, where the responsibility for vessel and navigational safety standards lies. However, this may have implications on program commitments and workload and would likely require legislative or regulatory change.

8.89 There is no organized collection and analysis of information on which to make decisions regarding small boat safety awareness, promotion and regulation. Such an analysis could provide a profile of the small boating population and indicate the causes of small boat incidents. It could also identify which prevention measures would be most successful. Provincial co–ordination and co–operation would be required in the collection of this information and in effective regulation and enforcement.

8.90 The Canadian Coast Guard should examine the options for collecting information on small boat activities with the assistance of the organizations involved in small boat safety. The causes of small boat incidents should be reviewed by the Coast Guard and the results used to redirect prevention efforts, including promotion, regulation, enforcement and investigation.

Canadian Coast Guard response: *Agreed. Efforts are underway to ensure that prevention efforts target the major causes of small boat incidents. In addition the Canadian Coast Guard will continue to work with the appropriate non–federal and non–governmental organizations.*

Cost recovery possibilities exist

8.91 The federal government provides services that do not directly contribute to the program objective of preventing the loss of life and injury in search and rescue incidents. These services include the provision of towing in non–distress marine incidents.

8.92 We noted that there were 6,804 incidents involving the towing of vessels in 1989 and 1990. Although in some cases towing is required to protect other vessels or the environment, most of these were incidents that did not involve a distress situation. Where there is a reasonable basis to determine that people are not in distress or potential danger, there are opportunities to recover the costs for services provided by search and rescue resources or to expand private sector operations to provide assistance on a commercial basis.

8.93 The Canadian Coast Guard should consider the opportunities to recover costs for services that are not directly related to the search and rescue program objectives.

Canadian Coast Guard response: *Agreed. However, any cost recovery policy must be carefully structured so as not to deter those legitimately requiring assistance from requesting help before their situation further deteriorates to a more serious emergency.*

Chapter 9

Employment and Immigration Canada

Employment – Monitoring Performance Against Expectations

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Assistant Auditor General: Robert Lalonde
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Employment and Immigration Canada

Employment – Monitoring Performance Against Expectations

Main Points

9.1 In an overall program context, Employment and Immigration Canada's (EIC) program evaluation has not examined the impact of its efforts on the labour market. However, the evaluations of program components were found to be of acceptable technical quality in terms of its selected measurement objectives.

9.2 We believe that the ongoing performance measurement system for some components audited should be enhanced to ensure that timely and complete effectiveness information is available at all management levels.

9.3 Given the large number of agreements at EIC, managers cannot be expected to exercise the same degree of control for each agreement. Control should vary with the level of risk and complexity of the agreement. In this regard, initial project approval is a crucial step for managers. However, vague project objectives, coupled with imprecisely defined local labour market needs and priorities, prevent EIC from selecting projects on the basis of merit. This situation increases the need for subsequent monitoring.

9.4 EIC does not respect its own minimum requirements for financial and activity monitoring practices. Furthermore, the Department does not have a strategy for choosing projects to be assessed at the end of the agreement. Limited information is derived from the monitoring of projects. More complete information resulting from the close–out assessment of projects would allow EIC to identify lessons learned that would improve subsequent project selection.

9.5 Although the Community Development Program relies on community–generated initiatives to improve the labour market situation, we found that few of the five–year strategic plans were truly strategic and that the data necessary to measure the impact of implemented initiatives were neither identified nor collected.

9.6 The eventual establishment of local labour boards could help EIC strengthen its mechanisms to ensure that funds available under the Unemployment Insurance Act for training are used effectively.

9.7 Parliament requires reliable information about EIC's activities and their effects on the labour market. It has been informed of EIC's mission, activity objectives and major lines of business. But it has not received evaluation evidence of the effectiveness of EIC's efforts to achieve its overall objective.

Introduction

9.8 Employment and Immigration Canada (EIC) comprises the Canada Employment and Immigration Commission (CEIC) and the Department of Employment and Immigration, both of which were established under the 1977 Employment and Immigration Reorganization Act. The Department is responsible for the effective development and implementation of federal policies and programs relating to the labour market, while the Commission is responsible for the administration and operation of the various components of the Employment and Insurance Program and the Immigration Program.

9.9 EIC, in co–operation with other government departments and the private sector, is responsible for developing, co–ordinating and administering federal policies and programs that are directly linked to Canada's labour market and immigration requirements. EIC's objectives are set out in its official Mission Statement:

> "At EIC, we help people find jobs or collect Unemployment Insurance benefits between jobs. We manage the entry of immigrants, refugees and visitors. We help workers and employers change as the workplace changes. We also help people learn new skills or start businesses."

9.10 The programs that EIC delivers are the Employment and Insurance Program, the Immigration Program and the Corporate Management and Services Program. The mandate and the objective of the Employment and Insurance Program are described in Exhibit 9.1.

Background

9.11 In a 1989 policy paper entitled Success in the Works, EIC outlined the labour market issues and conditions that were anticipated for the 1990s. This policy paper points out that the economic prosperity and standard of living enjoyed by Canadians depend on our competitiveness in the world market. High technology and the development and training of the work force will be essential to the growth of productivity. Skill requirements are changing; workers will need to have not just different or more highly developed skills, but also a broader range of skills.

9.12 The Canadian economy, like those of other industrialized countries, is evolving. The service sector is increasingly becoming the dominant force in our economy. The policy paper notes that matching workers to jobs will be a difficult challenge because of the inherent diversity of the service sector. Unemployment rates can vary considerably from one region to the next, depending on whether the regional economy is diversified or has an industrial infrastructure based on natural resources.

9.13 Statements in EIC's 1992–93 Estimates Part III about the external factors influencing the Employment and Insurance Program are summarized in the next three paragraphs.

9.14 EIC emphasizes the need for workers to continue their training throughout their entire careers so that they can keep their skills current or widen their fields of competence. The kinds of occupations practised are changing, and the demand for workers with more specialized skills is rising considerably. Workers who are unskilled and have little formal education are very vulnerable in these times of change in the labour market and in occupations. The situation is exacerbated by Canada's drop–out rate (almost 30 percent) from secondary schools.

9.15 The inadequate skill levels of the Canadian work force could be attributed in large part to the insufficient training provided by the business community. Formal training is offered to employees by only about 25 percent of businesses, mostly large companies. The training offered by small

Because of the advent of the Labour Force Development Strategy, Employment and Immigration Canada now administers much larger budgets with essentially the same number of people.

businesses is informal, for the most part, and is often curtailed by their lack of financial resources and high rate of employee turnover. Some of Canada's major competitor countries allocate a large share of their resources to training and developing the work force.

9.16 To meet the challenges of the 1990s, Employment and Immigration Canada sought to change its method of dealing with Canadian workers by adopting the Labour Force Development Strategy (LFDS). Prior to its introduction, the main purpose of federal labour market programs was to provide temporary income support to unemployed workers. The LFDS allows a larger share of funds in the Unemployment Insurance Account (UIA) to be used for training and offers new programs and services for Canadians facing serious difficulties in the labour market.

9.17 The Canadian Labour Force Development Board (CLFDB) was established in 1991–92 to provide advice and recommendations to the Minister of EIC on developmental uses of the UIA. The National Aboriginal Management Board (NAMB) was also created in 1991–92 to monitor and review programming initiatives as they apply to Aboriginal people.

Exhibit 9.1

Employment and Insurance Program

Mandate

The Unemployment Insurance Act is the legislative base for the Employment and Insurance Program. The Program exercises its mandate through the Unemployment Insurance Act and Regulations (including job creation, work sharing and training benefits); the National Employment Service Regulations; the National Training Act and Regulations (formerly the Adult Occupational Training Act and Regulations); the Labour Mobility and Assessment Incentive Regulations made pursuant to the Appropriation Acts; and the Employment Equity Act.

Objective

The objective of the Employment and Insurance Program is to develop and support the economic use of labour market resources in Canada, wihout undue burden on individuals, groups and regions, in co–operation with other government departments and the private sector, respecting the principles of equity in employment and ensuring the protection of public funds in order to promote the effective and efficient functioning of the Canadian labour market.

9.18 Employment and Immigration Canada (EIC) has adopted new structures for the Employment activity to improve its service to clients. Built on the National Employment Services and the Canadian Jobs Strategy (CJS), these structures stress flexibility and greater decentralization, as well as participation by the private sector and by local organizations.

9.19 The Commission introduced major changes to its systems in order to rationalize employment programs and make their delivery more flexible and to simplify administrative procedures. The implementation of on–line systems for the management of Employment activities and funds was completed, and an expanded computerized inventory of worker clients and employer job orders was developed. With the advent of LFDS in 1989, extensive automation of services to the public was initiated for the Employment and Insurance Program.

9.20 The new Boards (CLFDB and NAMB) require additional consultation with EIC management to ensure that they understand EIC's programs and services and are provided with labour market information. In addition, information from the planning and budget management systems has to be integrated into planning documents and business plans.

9.21 Employment and Immigration Canada operates in co–operation with other federal and provincial/territorial departments and agencies, as well as with individuals and organizations in the private sector. EIC also participates in a large number of sectoral co–operation agreements administered by other federal departments. While Canada Employment Centres (CECs) and other labour market stakeholders have been given more leeway in delivering EIC programs, they should take local needs into consideration. Local organizations work as full–fledged partners to help develop and carry out certain activities.

9.22 According to the Estimates Part III, the number of person–years allocated to the Employment activity was 7,691 for 1991–92 and 7,886 for 1992–93. As shown in Exhibit 9.2, funds available under the Unemployment Insurance Act have practically tripled from $560 million to $1.4 billion, while program funds have slightly decreased to $1.4 billion. Estimates for 1992–93 call for a further increase of funds under the UI Act to approximately $2 billion and a decrease of program funds to $1.2 billion. Participants in CJS programs have averaged about 400,000 for the past three years, and some 300,000 more are expected to benefit from the additional funds available under the Act.

9.23 To support the Employment and Immigration Program, the Employment activity seeks to:

- facilitate decision making by individuals, employers, organizations and institutions concerning labour market needs;
- improve the employability of selected individuals and facilitate their successful integration into appropriate employment;
- encourage more employers to assume responsibility for meeting the changing skill needs in the workplace; and
- develop local employment opportunities and help communities to both assess their employment problems and implement programs to solve these problems.

9.24 Full implementation of the new Employment activity structure will occur in 1992–93. According to EIC, success will hinge upon greater integration of activities traditionally carried out by Employment and Insurance staff, consultants, and designated group co–ordinators. Extensive personnel training programs have been initiated to prepare staff for the changes.

Objectives, Scope and Criteria of the Audit

9.25 The main objectives of our audit were to determine whether selected Employment sub–activities were managed with due regard to economy and efficiency, whether satisfactory procedures were in place to measure and report on effectiveness, and whether they were carried out in compliance with the applicable Act, Regulations and directives.

9.26 We selected projects and agreements for audit from components of three Employment sub–activities: Information and Special Initiatives, Labour Market Adjustment and Community Development. We also audited the Work Sharing and Job Creation projects financed under sections 24 and 25 of the Unemployment Insurance Act. Where appropriate, our audit also relied on the work and reports of the Internal Audit Bureau and the Program Evaluation Branch.

9.27 The components subjected to audit totalled close to $719 million or 25 percent of total program funds for 1991–92; these are shown in Exhibit 9.2. We excluded the Employability Improvement sub–activity from our selection because of possible changes resulting from the multilateral meetings on the Constitution, as well as the implementation of the new structure and the federal/provincial agreements under negotiation at the time of our audit.

9.28 The conceptual framework used in our audit is presented in Exhibit 9.3. Parliament gives legislative direction and approves funds to support relevant programs. It expects the funds that it allocates to EIC to be spent for the purposes specified. EIC has an obligation to obtain value for money and is accountable to Parliament for the results the Department achieves.

9.29 Feedback on results is provided at two levels: on outputs (for example, a contribution to alleviate

Exhibit 9.2

Program Funds — Employment Activity

Sub–Activity	Component	1991–92		1990–91	
		CRF (000$)	UIA (000$)	CRF (000$)	UIA (000$)
Information and Special Initiatives					
	Innovations	14,195		20,892	
Employability Improvement					
	Project–based Training	224,054		238,401	
	Purchase of Training/ Income Support	428,891		603,526	
	Employment Assistance	17,642		409	
	Youth Initiatives	153,402		132,091	
	Job Opportunities	53,416		59,435	
	Mobility Assistance	7,287		8,248	
	Delivery Assistance	34,949		28,923	
	Other	10,579		3,320	
Labour Market Adjustment					
	Human Resource Planning	14,906		10,366	
	Industrial Adjustment Service	21,066		16,853	
	Workplace–based Training	73,574		77,194	
	Labour Market Adjustment Assistance	9,287		9,755	
	Work Sharing (section 24 of the U.I. Act)	0	147,032	0	113,883
	Other	2,490		250	
Community Development					
	Community Futures	139,630		105,209	
	Self–Employment Assistance	43,801		36,200	
	Local Projects * (including section 25 of the U.I. Act)	173,679	117,441	214,025	112,099
	Other	0		2,733	
	Sub–Total	1,422,848	264,473	1,567,830	225,982
Other Unallocated Funds					
	Training in accordance with sections 26 and 26.1 of the Unemployment Insurance Act		1,170,240		333,665
	Total	1,422,848	1,434,713	1,567,830	559,647
Grand Total		2,857,561		2,127,477	

▨ : Audit Scope
CRF : Consolidated Revenue Funds
UIA : Unemployment Insurance Account
U.I. : Unemployment Insurance
* : This component includes both Job Development – General Projects and Job Creation Projects, section 25 of the UI Act.

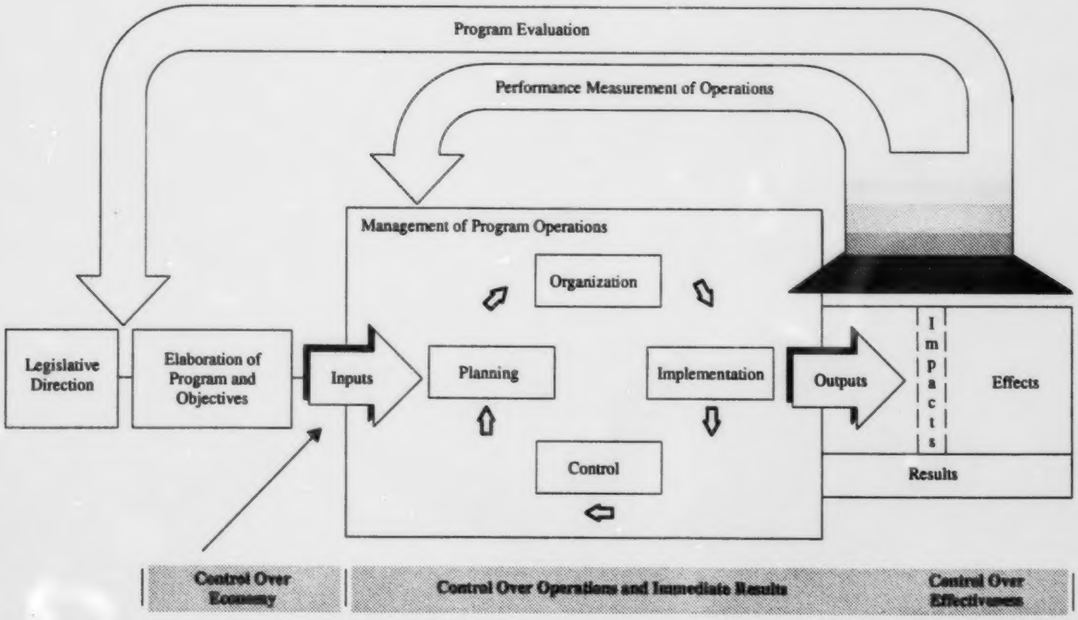
skill shortages) and on outcomes. Initial outcomes, or impacts (such as the number of jobs created), would be followed by the effects of programs (such as improvement in the match between supply and demand in the labour market). Performance measurement and program evaluation are directed at both outputs and outcomes. Performance measurement focusses on the ongoing measurement of outputs (whether internal or external to operations) and is essential to improving program management. Program evaluation is more oriented to the periodic re–examination of the program in the light of its legislative mandate, its success and its cost–effectiveness. Effectiveness measurement serves to inform the operational levels of the organization and to periodically provide information to senior management and to Parliament.

9.30 Effectiveness measurement means the monitoring of performance against expectations. Through this formal mechanism, lessons are learned that lead to program improvement. Performance is monitored to determine what is being accomplished and how this compares with targets, whether they are focussed at the local community or at the national level. Measurement is an essential management tool for keeping activities on track and ensuring that program mandate and objectives remain relevant. Exhibit 9.3 underlines the importance of having results fed back into operations and into program planning to improve program design.

9.31 EIC requires appropriate assurance from its operations throughout the country that funds allocated to local projects are well spent and used for the planned objectives. In addition to monitoring individual programs, senior management also needs to ask questions about relative effectiveness. Are the results of various strategies

Exhibit 9.3

Conceptual Framework Used in the Audit of EIC


Program Evaluation
Performance Measurement of Operations
Management of Program Operations
Organization
Legislative Direction
Elaboration of Program and Objectives
Inputs
Planning
Implementation
Outputs
Impacts
Effects
Control
Results
Control Over Economy
Control Over Operations and Immediate Results
Control Over Effectiveness

Program evaluation has not yet been directed to the whole program. However, within their scope, the evaluations of program components were of acceptable quality.

such as direct expenditures different from those of partnership–directed expenditures? Is one strategy more cost–effective than another? At the level of overall program effects, is management satisfied with its program design and can it give assurance that direction from Parliament is being followed?

9.32 The common theme of this audit is the adequacy of the Department's monitoring performance against expectations. The questions we ask with respect to global objectives, program components, individual projects and partnership agreements are: Does management obtain, in a cost–effective way, reliable information on the results of its efforts? Does management use such information to continually improve programs and, where appropriate, discontinue them or recommend appropriate program changes to the minister or Cabinet?

Observations and Recommendations

Program Evaluation

9.33 Each year, EIC works on about three pre–evaluation studies and six program evaluation reports related to the Employment activity. We audited eight of these evaluations, costing about $4 million, approximately 0.1 percent of the Employment activity funds. We examined the relationship of the questions asked by these eight evaluations to the program components on which they were focussed. We concluded that, in general, the evaluation studies addressed the objectives of targeted program components (for example: meeting changing skill needs in the workplace; developing local employment opportunities).

Overall, the quality of evaluations was acceptable

9.34 We assessed the quality of the eight evaluation reports on the components included in the scope of our audit. With the exception of one study, the evaluations were of at least acceptable technical quality.

Evaluation has not yet addressed the overall program objective

9.35 We found that the studies did not provide the basis for considering the contribution that the evaluated components made to the objective of the whole program: to promote the effective and efficient functioning of the labour market. Our audit did not examine the entire Employment and Insurance Program; therefore we were not able to conclude on whether other functional elements of EIC have fulfilled this responsibility.

9.36 Evaluating progress toward this national policy objective is of significance to government and to Parliament. About $3 billion dollars are now spent annually by EIC on labour market programming. Is the money being spent in the best way? Answers, even approximate answers with identified margins of error, should be sought and brought forward for debate.

9.37 The program evaluations we examined, although of acceptable technical quality within their scope, did not address important cross–linking Employment activity issues that considerably influence the Department's success. Examples of issues not yet addressed by evaluations include the impact of immigrants and of the education system on the functioning of the labour market.

Important questions about serious labour market problems also need to be addressed

9.38 The summaries of program evaluations indicate that Employment activity components generally achieve their objectives, particularly concerning the possibilities of finding jobs for participants or improving their financial circumstances. These evaluation findings are issued against the following background: a rising trend in the rate of unemployment; a polarization of employment opportunities into "good" jobs and "bad" jobs; and increasing numbers of workers who experience long periods of joblessness. These are important questions that need to be addressed.

Evaluation scope should be re–examined

9.39 Since 1985–86, the Department has published about 40 evaluation reports, covering most of the Employment activity. The scope of these evaluations was generally restricted to components within sub–activities. To determine which program components should be evaluated, EIC needs to include the criteria of importance, cost–effectiveness and cross–linkage.

9.40 The Department should design evaluations to probe more fully the cross–linkage influences on the success or failure of the program and the impact of its activities on the functioning of the labour market.

Department's response: EIC will continue to strategically allocate its program evaluation resources to maximize their effectiveness in meeting the evaluation needs of the Commission's management and the Treasury Board. It will expand its program evaluation analyses, where cost–effective, to take into account cross–linkage influences and the impact of its activities on the labour market.

Ongoing Performance Measurement

9.41 Ongoing performance measurement is essential to improved program management, as shown in Exhibit 9.3. EIC recently adopted a new Operational Planning Framework (OPF), which modified the performance indicators for the Employment activity. That framework was approved by Treasury Board in January 1992. Implementation of the framework started during fiscal year 1991–92. This new activity structure became effective on 1 April 1992.

The production of performance measurement reports is not always timely

The ongoing performance measurement system does not produce timely and complete effectiveness information for some components of Employment programs.

9.42 We reviewed the five regular performance measurement reports related to the Employment activity. We found that only one report, the Executive Review of Results Report, is produced on a timely basis. We observed major delays in the production of the other four reports. As a result, the available information is not up–to–date and its usefulness to managers is greatly reduced.

Data are not formally interpreted

9.43 We could not find evidence that the Department formally assesses the data to interpret the consequences of differences between planned and actual results, to compare components and regions, and to identify trends in performance over time. Comparison is of the essence when using performance indicators. To be meaningful and useful, levels of performance should be assessed, allowing corrective measures if necessary. We identified only one study that analyzed the data generated by the participant follow–up system; it was issued more than two years ago, in February 1990.

Some effectiveness performance indicators are missing

9.44 We found that indicators of financial and process performance, which are essential, were well identified and used. Our analysis of the new indicators proposed in the OPF for several of the components subjected to audit revealed that they are not complete and do not always measure, among other things, whether the target populations have been reached and whether the desired results have been achieved. We also observed that the performance measurement reports did not produce information in relation to the new performance indicators of the Community Development sub–activity. Thus, the performance indicators proposed for these components do not yet measure key elements of effectiveness in relation to the objectives of the programs.

The performance measurement reports are of limited use to Canada Employment Centres

9.45 Since managers of Canada Employment Centres (CECs) are required to develop local planning strategies, they should have the information needed to make informed decisions. CECs obtain only a limited amount of information from the performance measurement system. It does not provide managers with knowledge of the degree to which results are achieved through their interventions.

9.46 We recognize that there are at least two approaches for monitoring performance. One approach relies on indicators within a performance measurement system. Another approach relies on information obtained from project control measures. Both approaches are valid, and one may complement the other. In light of deficiencies that we identified in project control and of EIC's decentralized organization, we believe that management at all levels would benefit from an increased emphasis on effectiveness indicators in its performance measurement system.

9.47 The Department should ensure that:

- **indicators are complete and measure the key effectiveness elements of program objectives;**
- **information is gathered for all indicators selected;**
- **ongoing performance measurement reports are timely and appropriate for all decision–making levels; and**
- **CEC managers are provided with information on the degree to which results are achieved through their interventions.**

Department's response: *In the transition between the old and the new program frameworks, EIC's overriding consideration had to remain the quality of service to its clients. Nevertheless, EIC agrees that priority must also be given to comprehensive and timely performance measurement. We have so demonstrated by working with Treasury Board and the Office of the Comptroller General to develop indicators that focus on outcomes and objectives achievement rather than processes.*

Employment performance measurement systems do not yet report on all possible aspects of program performance, but they do provide a comprehensive overview of measures reflecting the efficiency, effectiveness and quality of EIC interventions. Developmental work on additional measurements is continuing. Supporting management information systems are gradually coming on stream.

As well, in 1993–94, the Executive Review of Results Report (ERRR) will be enhanced by the inclusion of additional key measures. Outcomes on Community Development activity will also be available towards the end of 1992 through the Community Futures Committee and Business Development Centre reports as well as participant survey results for Self–Employment Assistance (SEA) and local general projects.

These measures, combined with recent and planned enhancements to the management information systems, will provide increased and more timely access by regions and CECs to on–line performance feedback. They will also facilitate the ongoing processes (Executive Committee and National Operations and Programs Committee) whereby senior management analyze and act on emerging performance issues.

EIC will ensure that all performance measurement information is made *available on a timely basis. Although delays have occurred in incorporating all performance measures into regular corporate reports, work is under way within the context of survey development to provide CEC managers with selected results information. This information would be provided periodically to each CEC in order for them to track progress. The cost of providing regular ongoing results to every CEC based on survey results is prohibitive for EIC to consider.*

Control of Projects

9.48 Proposals for funding are made, and if they are approved, an agreement is signed between EIC and a third party, such as an employer or a sponsor. Excluding the Youth Initiatives, EIC concluded close to 42,000 agreements for the Employment activity in 1991–92. The CECs and other local offices are responsible for managing the projects that stem from these agreements.

9.49 We examined over 220 agreements with respect to the following components of the Employment activity: Community Futures, Local Projects (Job Development – General Projects and Job Creation projects, section 25 of the UI Act), Workplace-based Training, Work Sharing (section 24 of the UI Act), Labour Market Adjustment Assistance (Training Trust Funds), and Labour Market Innovations. In 1991–92, the total number of agreements for these components was 25,500.

9.50 Control of projects is an integral part of the management of program operations. Managers must ensure that resources are put to optimum use with prudence and for the stated purposes. To that end, control measures are normally exercised throughout the life cycle of a project, at the following stages:

- analysis of project proposals;
- monitoring of the project; and
- closing–out of the project.

One purpose of control is to evaluate progress on an ongoing basis toward targeted results and to take appropriate and timely corrective action.

The 1991–92 components subjected to audit represent 25,500 agreements with a budget close to $719 million.

9.51 Given the large number of agreements at EIC, managers cannot be expected to exercise the same degree of control at each of the above-mentioned stages for every agreement. Control should be appropriate to the circumstances and vary with the level of risk, such as the complexity of the agreement and the ability of sponsors to meet agreement requirements. In this regard, initial project approval is a crucial step for managers; it allows them to choose projects on the basis of merit and the likelihood of achieving the targeted results. A careful analysis of proposals can reduce the need for subsequent monitoring.

9.52 In the following paragraphs, we describe the weaknesses we observed at each stage of the life cycle of projects.

A more strategic analysis of local labour market needs and priorities is required to select the most deserving projects

9.53 Every year, CEC managers are responsible for preparing a strategic plan. CECs, in consultation with their community partners, determine the labour market needs of their community and, where intervention is deemed appropriate, plan the most effective program and/or service responses. Our audit revealed that the CECs' strategic plans do not set sufficiently precise priorities and objectives. Consequently, project officers cannot rely on these plans as a guide for making decisions to finance deserving projects. Moreover, CECs do not evaluate the degree to which the year's activities have met the objectives identified in their strategic plans.

For three of the components audited, project objectives were not sufficiently precise

9.54 According to EIC's operational procedures, every project should be based on an agreement containing clearly defined performance objectives against which benchmarks can be established to measure progress and success. The objectives are essential to the control aspect of agreement monitoring and must be reflected in the narrative section of the agreement.

9.55 We found that project objectives were not sufficiently precise for the following components: Local Projects, Workplace–based Training and Labour Market Innovations. In one region, of the 18 Local Projects (Job Development – General Projects) agreements we examined, only two specified the probability that participants would find permanent employment on the local labour market or pursue their occupational training. In two regions, 22 of 45 agreements (49 percent) for Workplace–based Training did not stipulate the way in which training was expected to support the objectives and priorities of the program.

9.56 Another example of vague objectives is observed in the Job Creation projects. Section 25 of the UI Act provides for the use of UI benefits for the creation of new employment opportunities for laid–off workers during periods of economic downturn where no other productive activity exists. Under the authority of the UI Act, EIC allows individuals who are receiving UI benefits to participate in projects designed to enable them to retain their skills or to gain new skills. Local managers approve these projects, after taking into consideration the recommendation of a Member of Parliament. In general, we noted that project proposals did not set sufficiently precise goals for participating UI recipients. In the 25 project files we audited, only two proposals clearly specified the objectives that UI recipients were to achieve. The other 23 project proposals contained no description of the skills to be maintained or acquired, effectively making it impossible to measure whether project objectives for recipients were achieved.

9.57 Agreements examined under the Labour Market Innovations component had vague objectives. The component was developed as an instrument for gathering and analyzing information on the feasibility, acceptability, effectiveness and efficiency of different approaches to solving labour market problems. It can succeed only insofar as projects focus on major labour market problems. The Program Evaluation report revealed that most of the projects had not been designed to test innovative methods, and that those methods were not very well documented.

Eligibility criteria for the Training Trust Funds and Work Sharing components are not applied consistently

9.58 There is a need to ensure that eligibility criteria are applied consistently so that clients receive fair and equitable treatment. This is particularly important in a decentralized organization. Our audit of Training Trust Funds (TTF) revealed that EIC either does not require organizations to provide the necessary information for complete analysis and decision making or, if it does so, does not make use of that information. As a result, EIC does not have the necessary information to ensure that TTF officials spend the money they receive on eligible training and recipients.

9.59 Although viability is the main eligibility criterion, EIC does not evaluate the potential for Training Trust Funds to become self–sustaining. The objective of a TTF is to assist employed workers to adjust to labour market changes by contributing to the increase in the quality and volume of training in the workplace. EIC contributes to a TTF for a specific period of time, with the objective that the fund will then continue to function and provide necessary training assistance without federal participation. Since the Department did not have aggregate information on the extent to which the self-sustaining objective of the component was being met, we requested confirmation from 60 TTFs as to the continued existence of their funds. The answers revealed that 25 (or 42 percent) were dissolved following the end of EIC financing, thus not achieving the self-sustaining objective. EIC contributed approximately $5 million over a period of five years to these dissolved TTFs.

9.60 The eligibility criteria for the Work Sharing component were used inconsistently in two respects: the information requested from employers as a basis for applying the criteria and the analysis of the actual proposals. These inconsistencies stem from the different interpretations of the EIC's operational procedures. These procedures stipulate that the employer must demonstrate that the shortage of work is significant enough to warrant the use of work sharing. The duration of the agreement is based on the length of time needed for the company to recover fully. Some local offices requested a great deal of information from employers and specific proof that work sharing was necessary. The information was then carefully analyzed; the duration of the agreement was based on the actual decrease in the employer's activities. Other local offices requested minimum information, and the duration of the agreement was based on the recovery plan submitted by the employer. Finally, some local offices requested minimum information and performed a limited analysis, yet the maximum duration of an agreement was granted.

The minimum monitoring requirement set by EIC is not respected

9.61 EIC requires the progress of activities to be monitored during the course of a project. Such monitoring makes it possible to exert both a financial and an activity control. This can take the form of activity reports submitted by the sponsor, on-site visits, telephone follow-ups or independent audits. The appropriate level of monitoring is determined by the management of each Canada Employment Centre or local office, taking into account the resources at its disposal.

9.62 A strategy on the monitoring of agreements has been developed by Headquarters; although it represents a minimum requirement, it is not respected. This illustrates a lack of commitment by CECs. Managers are under pressure to deliver programs and to spend within their authorized budget levels. They therefore allocate their resources accordingly.

9.63 The following examples, drawn from Work Sharing and Job Creation project files, illustrate weaknesses in the monitoring of agreement activities.

9.64 Operational procedures stipulate that the monitoring of Work Sharing agreements should include control visits with sampling of employer payroll records. Officers adhered to these procedures in only one of the 10 centres we visited. However, most of the centres visited were trying to cope with the high demand: The total number of agreements went from 1,800 in 1989 to 10,900 in 1991.

9.65 For Job Creation project agreements, operational procedures require a minimum of three visits per project. This requirement does not take into account the amount of funds allocated to the project, risk analysis, and activity reports (if any) submitted by the sponsor. We also noted that the monitoring of agreements was inconsistent. For some projects there were two or three monitoring visits in addition to the activity report by the sponsor, while for no discernible reason, others of equal importance received no attention.

9.66 Although it is no substitute for on–site monitoring, the review of project activity reports represents a minimum level of control. EIC often did not request activity reports. Even when these reports were received, there was no documented evidence that project officers had carried out an effective analysis of activities in progress.

9.67 The Department has recognized weaknesses in the financial monitoring of agreements. The Internal Audit Bureau of EIC conducted several audits over a two–year period and made the following observations regarding financial monitoring of agreements:

- The documentation of project files is incomplete: Key control documents, such as project risk evaluations, monitoring plans and reports, were either incomplete or non–existent.
- Projects are monitored by various groups, but information is not presented in a uniform way that would make possible the effective exchange of results.
- Most of the project management problems observed could not have been identified by simply reviewing files; file monitoring cannot, therefore, be used as a substitute for on–site monitoring to ensure proper project management.
- Monitoring visits are carried out by the same project officer who recommends approval of the project, approves monthly payments and provides guidance and support to the sponsor on the management of the project.
- Staff responsible for financial control lack training.

9.68 To correct the weaknesses identified by the Internal Audit Bureau, EIC has commissioned a task force to seek ways of improving monitoring procedures without requiring an increase in resources. A preliminary update report of this task force was scheduled for release in September 1992.

For three of the components audited, there is no valid close–out process

9.69 According to EIC's operational procedures, it is important, upon termination of an agreement, to evaluate the extent to which targeted objectives have been achieved and the degree to which the results justify the cost. This assessment is valuable because of what it says about a sponsor's ability to fulfil the obligations of the agreement and to effectively administer a project. This would affect whether EIC would enter into an agreement with the sponsor in the future. It is also valuable for the data it provides on the effectiveness of the component generally. We believe the close–out assessment can also provide the basis for identifying lessons learned to improve subsequent project selection.

9.70 For Local Projects and Workplace–based Training components, there was no valid close–out process that could be used for ongoing assessment and could reorient the program if necessary. As stated previously, the project objectives are not sufficiently precise. Therefore, project officers cannot do a valid close–out assessment. At present, such assessments simply do not exist, or, if made, are brief and incomplete. Because there are no complete assessments by which to gauge the achievement of objectives, managers cannot know the immediate results of their activities.

9.71 Since the vast majority of project sponsors receive program funds year after year, it would be appropriate to consider project merits and past results when selecting projects. This information was generally lacking in the files we audited. Thus, project results cannot be shared and lessons cannot be learned that could improve subsequent project selection.

9.72 For example, the Labour Market Innovations component can succeed only insofar as the results are reliable and are communicated to other stakeholders. The Program Evaluation report revealed that sponsors generally did not assess the results. Even when they did, their assessments did not address the question of effectiveness. The little information obtained on results was never published; its usefulness was limited.

9.73 Given the high volume of agreements at EIC, managers cannot be expected to perform a close–out assessment for each project. The strategy for selection of projects to be assessed should include risk analysis and should also be appropriate to the circumstances.

9.74 Excessive controls can be counter–productive. However, we believe that the control of projects is both essential and cost–effective. The feedback it provides on results achieved is an important contributing factor in the sound management of program funds.

9.75 To improve the control of projects, Employment and Immigration Canada should:

- **ensure that project objectives are clearly stated;**
- **select projects based on a more strategic analysis of the local labour market needs and priorities;**
- **perform monitoring in a more efficient and effective manner;**
- **develop a strategy for the selection of projects to be assessed at the close–out of an agreement; and**
- **use the aggregate information generated by the close–out assessments as a basis for identifying lessons learned that would improve future project selection.**

Department's response: *Caution must be used in drawing general conclusions from the audited sample. The nature of the program components audited is varied and complex and not representative of EIC's full range of responsibilities. It must be recognized that the local level has neither full authority nor unlimited capacity. Signing authority is linked to the value and nature of the contract. There are circumstances where projects are approved at the regional, national and ministerial level. This reality can affect the choice of projects approved.*

We are reviewing our reference and program materials to ensure that project objectives are clearly stated in agreements.

The Department established a Planning and Accountability Process for the local level in the last year and a half. The implementation of this process is now well under way. The guidelines will be reviewed to ensure that the necessary linkages to the selection process are established.

EIC's expectations in terms of project monitoring are demanding. Although managers at all levels remain committed to these principles, other service delivery requirements have made it more difficult to find the resources required to fully implement them. Nevertheless, EIC recognizes that monitoring efforts need to be improved. A Monitoring Task Force has several major initiatives nearing completion. These initiatives include the redrafting of our manuals, working tools and the development of a training package. The scope of monitoring is also being extended to better cover contracting and project close–out.

A selection strategy has been drafted and is now being finalized. This selection process is based on program

The close–out assessments of projects do not yield information that would allow Canada Employment Centre managers to learn, on an ongoing basis, about progress made toward targeted results and thus to improve subsequent project selection.

objectives, criteria, local needs and priorities. Information gathered in this exercise will be fed back into the planning process.

The Community Development sub–activity relies on community–generated initiatives to improve the labour market situation.

Partnerships

9.76 To achieve its program objectives, EIC relies on numerous partners in the public and private sectors, such as other federal departments, provincial ministries, business people and associations. These partnerships are formed through contractual agreements, co–operative agreements or joint activities for policy development, support and delivery of programs, and provision of services. It depends on a network of Canada Employment Centres and related points of service to identify and resolve local employment and insurance problems and provide feedback that is used to improve the efficiency of the Canadian labour market.

9.77 EIC offers services in 10 regions and 487 Canada Employment Centres. These in turn, can enter into partnerships to carry out their mandates. The Community Development sub–activity relies heavily on such partnerships with, for example, some 220 Community Futures Committees and 200 Business Development Centres.

9.78 Our audit focussed on how the Department manages its activities when program success depends on the actions of its partners. We examined the activities undertaken through some of the partnerships on which EIC relies for Community Futures. In regard to the Labour Force Development Strategy (LFDS), we reviewed the implementation of the proposed partnerships.

Community Futures

9.79 The mandates, roles and responsibilities of the organizations involved in a partnership must be defined clearly and precisely and must avoid overlapping with other programs. Although there may be several reasons for EIC to collaborate with a particular partner, there must be consensus on the objectives to be attained in order for the approach to be successful.

9.80 EIC's Community Development sub–activity relies on community–generated initiatives to improve the labour market situation. It supports the development of local employment opportunities and helps communities facing severe labour market problems to effectively organize their resources to:

- assess local problems and opportunities;
- establish realistic objectives;
- formulate appropriate plans; and
- implement strategies that are critical to the success of their plans and that promise significant impacts on the labour market.

9.81 To these ends, the Community Futures component provides financial support to assist communities in the development of human, institutional and physical infrastructure and the implementation of entrepreneurial, employment development and adjustment strategies.

9.82 A community is defined as a geographical area that includes a local government unit, or group of units, with common economic and employment characteristics or problems. To be eligible for EIC's support, communities must face serious labour market difficulties, lack adequate mechanisms to address the unemployment problem on their own, and normally be outside metropolitan areas and distant from more buoyant labour markets.

Relationships between Canada Employment Centres and Community Futures Committees are not fully established

9.83 As defined in EIC's operational procedures, Community Futures Committees (CFCs) are called upon to:

- develop an economic development and adjustment plan or strategy;
- secure and maintain the co–operation and participation of stakeholders and experts in implementing the plan; and
- verify the strategy's appropriateness to local needs.

CFCs also have a co–ordinating role in implementing other federal or provincial programs available to supplement or support initiatives by communities and the private sector. We note, however, that the committees are not responsible for implementing those programs.

9.84 Community Futures Committees share their territories with Canada Employment Centres, although the boundaries may vary. Both organizations are required by EIC to prepare strategies that address local needs. In its 1989 directives on planning in Canada Employment Centres, EIC management stipulates that, through the planning process, CEC managers are responsible for:

- liaison with existing provincial/ territorial and local agencies, in order to co–ordinate service delivery to the extent possible;
- identification of significant labour market issues that can and should be addressed by EIC;
- prioritization of labour market issues; and
- development of a strategy for the type and size of response appropriate to identified labour market issues;
- co–ordination of existing programs and services to provide the most effective response to identified labour market issues.

The directive further states that, within the scope of delegated authority, the single most important factor in ensuring excellence in EIC's performance is a strong and effective local planning process.

9.85 In five of the nine communities visited, we found that there was no liaison between the Community Futures Committees and the Canada Employment Centres concerned. The Community Futures program consultants responsible for assisting the communities generally report at the regional level. Relations between CFCs and EIC are thus established with program consultants, rather than with CEC representatives. Consequently, the co–ordination of strategic plans that involve shared territories is not assured.

9.86 The establishment of a Community Futures Committee and its membership are contingent upon the Minister's approval. The Community Futures options can be implemented only if the CFC recommends them as part of its local strategy and only if they are approved by the Minister. EIC enters into agreements directly with the sponsors of initiatives called for in the Community Futures Committee's plan.

Few of the strategic plans examined were truly strategic in nature

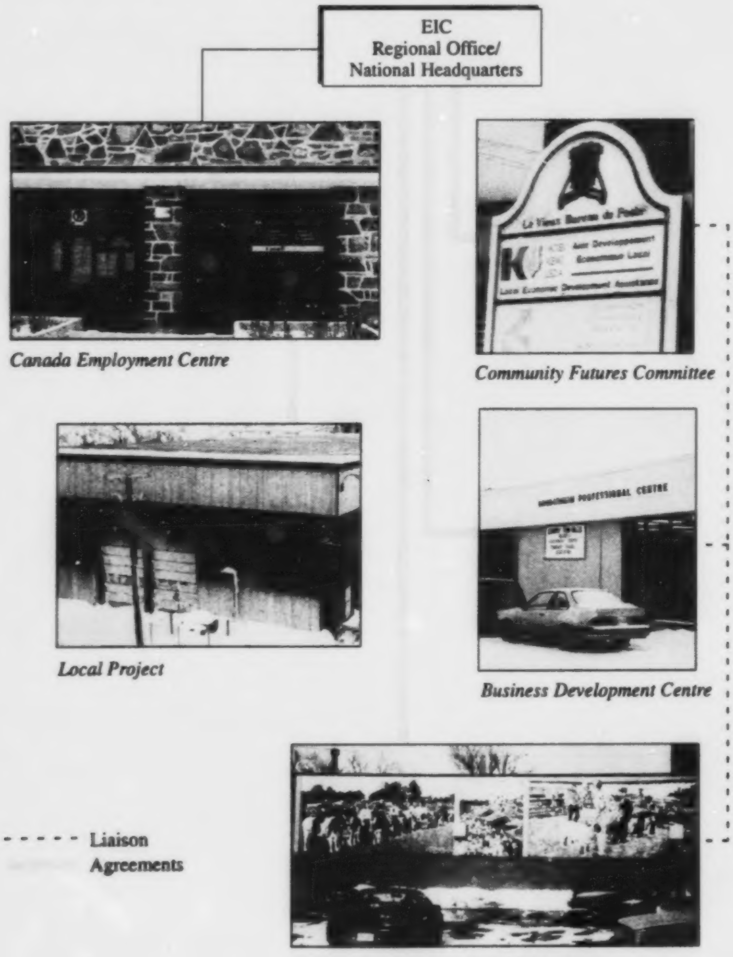
Few of the Community Future Committees five–year strategic plans examined considered alternative strategies. The data necessary to measure the impact of the implemented initiatives were neither identified nor collected.

9.87 Most Community Futures Committee five–year strategic plans that we audited focussed primarily on program options rather than on alternative strategies, such as the involvement of other public programs and the private sector. Only one community had prioritized its problems and had established a plan with a measurable objective and a variety of means to achieve it within the planning time frame.

9.88 The Community Initiatives Fund (CIF) is an option that is meant to be used to finance particularly worthwhile new initiatives. CFCs must consider whether such initiatives are vital in implementing the chosen strategy to stimulate long–term growth in employment and renewal of economic activity.

9.89 An analysis of the CIF projects approved since 1987 shows that more than 130 focussed on the development of sports or tourism facilities and 70 on the manufacturing sector as shown in Exhibit 9.4. Twenty-three of the 24 projects where funds were allocated to pay for necessary infrastructure were in these two sectors. The Exhibit also shows the distribution of CIF projects by types and sectors of activity, and by number of projects and dollars approved.

Local Partnerships



EIC
Regional Office/
National Headquarters

Canada Employment Centre

Community Futures Committee

Local Project

Business Development Centre

Community Initiatives Fund Project

- - - - - Liaison
Agreements

9.90 We examined 22 projects that were supposed to create some 2,000 long-term jobs. Some projects paved the way for subsequent job-creating projects — for example, road construction or the installation of municipal infrastructure that would facilitate the promotion of future projects.

9.91 In a community that had proposed three initiatives to EIC, we found that all three had been designed before the five-year strategic plan was completed and submitted to EIC for approval. Two of these initiatives were approved before the strategic plan. This is not in keeping with the eligibility criteria for CIF proposals, which require that initiatives be integral to the implementation of the chosen strategy. Investments of more than $5.6 million were required, and EIC contributed $1.6 million towards these initiatives.

9.92 In another community, EIC has spent more than $6 million for the construction of two sports centres in two localities about 20 kilometres apart. In each case, the amount of private investment was small. Other sources of financing were the provincial government and the municipalities. The total cost of the projects was $20.8 million. The two municipalities agreed to absorb the anticipated deficits once the centres were operational. Neither project was completed at the time of our audit. Although the projects did create jobs and the five-year strategic plan of the community had given priority to the tourism sector, the plan had not identified measurable goals for long-term growth in employment against which progress and the results of these interventions could be assessed.

9.93 In most CIF projects examined, the data necessary to measure the impact on the long-term level of employment were neither identified nor collected. Consequently, the impact of these projects on employment in the community could not be established. EIC is not in a position to assess the proposals and evaluate the results of these activities.

9.94 The expected results of the interventions of the Business Development Centres, another option of Community Futures, are expressed in terms of jobs created and maintained. A visit to ten of these centres revealed that the systems used by six of them to measure results were unreliable. These results do not enable the CFCs to assess the appropriateness of their strategic plans, since measurable objectives have not been set. In spite of this, the results are used by the Community Futures Committees to assess the option and recommend its continuation. The results are also included in their annual reports to EIC.

Employment and Immigration did not provide enough information on the program to Community Futures Committees

9.95 The guidelines used by committee members are those intended for EIC staff. In addition, committee members must be familiar with other federal and provincial programs upon which they may call. There is evidence of a large number of provincial programs providing funds for economic development. CFCs, however, rarely make use of these other sources of funds.

9.96 A 1981 evaluation of the Community Employment Strategy highlighted several important lessons for the design of employment programs and the involvement of local elements in the process. The strategy represented an attempt by the federal and provincial governments to involve communities in improving the design and targeting of services to the chronically unemployed. The evaluation report observed, among other things, that:

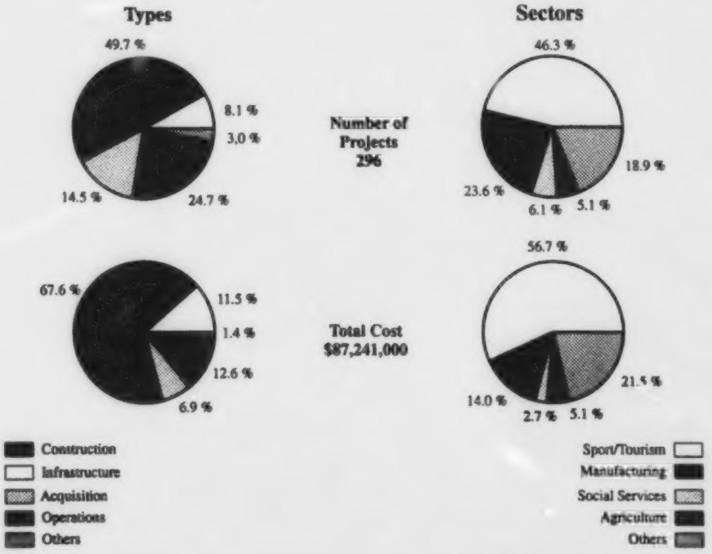
- the delineation of roles and responsibilities was not clear;
- the organizational structures supporting the program's objectives should have been matched to operational requirements in terms of their capacity to co-ordinate services and support locally based planning processes;
- the analysis of community readiness was inadequate in terms of organizational skills, knowledge of government programs and the type of support and development time required; and
- the planning horizons were too short; communities would have benefited from instruction in planning methods and from technical assistance.

EIC recently conducted two studies that addressed some of these issues. The recommendations resulting from the studies that may impact at the local level have yet to be implemented.

9.97 As we have noted, the harmonization and complementarity of activities between Canada

Exhibit 9.4

Community Initiatives Fund
Approved Projects: 1987–92



Employment Centres and Community Futures Committees is not assured. Few of the five–year strategic plans provide a basis for EIC to assess the initiatives to be financed by them. Appropriate mechanisms for measuring results by EIC or by the CFCs are not in place.

9.98 Employment and Immigration Canada should ensure that:

- **relationships are established between the Canada Employment Centres and the Community Futures Committees;**
- **future strategies provide a basis for assessing the initiatives to be financed by them; and**
- **appropriate mechanisms to measure the results of the interventions proposed by the Community Futures Committees are in place.**

Department's response: *The need for Canada Employment Centres (CEC) and Community Futures Committees (CFC) to actively involve each other in their operations, particularly in their annual strategic planning exercises, is clearly stated in various policy documents. Some initiatives are already under way to strengthen the relationship. For example, in a recent Business Development Centre (BDC)/CFC conference (September 1992) organized in Sorel for all CFCs and BDCs in Quebec, CEC managers were present for the very purpose of improving the relationship. It is also expected that the Goals and Measures project will contribute to an improvement of the harmonization of CFC objectives and CEC strategies through a better integration of CFCs' strategies to the Planning and Accountability Process at the local level.*

Current guidelines emphasize the need for initiatives to correspond to the objectives identified in the strategic plan of the community. In one of the examples mentioned, it is noted that a community strategic plan prioritized development in the sport and tourism sectors and proceeded to construct two sport centres. In the analysis of these two projects, it was considered that a large number of jobs would be generated during the construction of the centres, and that 63 permanent jobs would result in a community sustaining a high level of indefinite layoff in the forestry sector. As well, the need to encourage growth in tourism was a significant factor in the strategic plan.

There are numerous projects under way at this time that are expected to specifically address the concerns raised, including:

- *a community training project, under which a training program is being designed. This program will be given to all CFC and BDC board members and staff to enhance their ability to design and implement a strategic development plan;*
- *the training program that is currently being implemented for volunteers and staff of Community Futures Committees, which will increase their knowledge in the area of access to other federal and provincial programs and will also clarify EIC's expectations with respect to the CFCs' obligations;*
- *the Goals and Measures II project, which is designing work tools and procedures for CFCs to negotiate with EIC staff a set of observable performance measures that are consistent with the CFCs' strategic goals and will provide a measure of the CFCs' success in reaching those goals;*
- *a project to enhance the regularity and accuracy of reports of the CFCs' activities and their impacts; and*
- *the Goals and Measures project, which will affect all aspects of reporting and performance assessment by the CFCs and thus will*

result in more appropriate mechanisms to measure the results of CFCs' interventions and strategic plan.

Future Partnerships

9.99 The Canadian Labour Force Development Board (CLFDB) was established in January 1991. Its main role is to provide advice and recommendations to labour market partners concerning training and human resource development. It is responsible for promoting stronger links among education, training and the workplace, and for encouraging new sectoral and community training initiatives.

9.100 Since its establishment, the Board has made recommendations to the Minister of EIC concerning the productive use of Unemployment Insurance funds. It has also recommended more counselling services and an increase in EIC administrative personnel and resources. Accountability mechanisms between CLFDB and federal and provincial/territorial governments have yet to be defined.

9.101 The creation of provincial/territorial and local boards is planned for 1992–93. Local boards will provide guidance and strategic direction to the operation of training programs in their local areas, within broad guidelines established by the CLFDB and their provincial/territorial boards, and with reference to the economic and structural influences that have an impact on their local labour markets. The establishment of local boards will obviously be dependent on the establishment of their respective provincial/territorial boards.

9.102 It is expected that 60 to 70 local boards will be established during the next few years. Although none has yet been established, estimates of funds available under the Unemployment Insurance Act have practically tripled from $560 million to $1.4 billion since 1990–91. However, EIC management says it can ensure the productive use of these UI funds by several means. These include EIC's planning guidelines, the strategic plans of Canada Employment Centres and Community Futures Committees, federal–provincial/territorial agreements and sectoral studies.

9.103 We have observed that some of these means do not enable EIC to ensure that additional funds available for training are used efficiently and effectively. As we have already noted for the components audited, Canada Employment Centres do not set sufficiently precise and measurable objectives and priorities in their strategic planning. They do not evaluate the degree to which their objectives and priorities are achieved. We have observed similar problems with respect to the strategic planning of Community Future Committees. The quality and effectiveness of training under federal–provincial/territorial agreements have seldom been evaluated jointly by federal and provincial/territorial governments.

9.104 How can EIC ensure that the training it funds meets the needs of the labour market? Who will be accountable for measuring results achieved? Significant additional funds from the Unemployment Insurance Account have been available since January 1991, yet these questions remain unanswered.

Conclusion

9.105 EIC is accountable for the results it achieves. This applies to results at the global level as well as to the program components. It applies to locally funded projects as well as to nationally selected projects. It applies to partnerships with communities, associations, companies or individual clients, as well as with provinces and territories. Overall, EIC does not know, on an ongoing basis, the cost–effectiveness of its interventions. In this chapter we have described project control weaknesses and incomplete and untimely performance information.

9.106 We have also reported important deficiencies in the Department's monitoring of results with respect to overall objective, program components, individual projects and partnership agreements. Some can be corrected directly by EIC — but not all, particularly those dependent upon jointly undertaken activity. Where EIC works with other government departments and/or the private sector to improve the functioning of the labour market, its control task must recognize such multiplicity of interests. Nevertheless, the complexity this introduces to the accountability relationship does not remove it from parliamentary scrutiny.

9.107 Parliament requires reliable information about EIC's activities and their effects on the labour market. It has been informed of EIC's mission, activity objectives and major lines of business. But it has not received evaluation evidence of the effectiveness of EIC's efforts to achieve its overall objective. To what extent do EIC's expenditures contribute to the more efficient and effective functioning of the labour market? This important question remains unanswered.

9.108 This Office has, on several previous occasions, voiced its concern as to whether Parliament is receiving adequate information from departments on their management of public funds designed to achieve national objectives. We have underlined the need for measurable expectations by which to monitor the use of public funds transferred to other jurisdictions. We continue to be of the opinion that national objectives must be defined and mechanisms must be established to relate federal expenditures to national goals.

9.109 Regardless of the level of government that actually carries out the labour market programs, Parliament (as explained in Chapter 6) requires stewardship information, including the program mission; the major lines of business, the structures, the instruments and objectives designed to achieve the mission; and performance information showing to what extent public funds have been successfully used.

Chapter 10

Loans to Sovereign States

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Loans to Sovereign States

Assistant Auditor General: Bonnie Miller
Responsible Auditor: Barry Elkin

Main Points

10.1 Canada extends credit to individual sovereign states for many reasons: to promote development, to support foreign policy objectives and to facilitate export trade. Sovereign states owe Canada over $16 billion, of which $12 billion is owed to two Crown corporations — the Export Development Corporation and the Canadian Wheat Board.

10.2 The decision to extend credit to a country is complex and entails consideration of a number of factors, including those related to foreign and domestic policy, such as the promotion of Canadian agriculture. Granting credit to sovereign states also involves accepting risks. These risks take the form of delays or non–payment of loan interest or principal.

10.3 The government holds the view that sovereign loans are ultimately collectable unless formally repudiated. In 1990, in anticipation of debt relief measures agreed to by the international creditor community, the government provided an allowance for debt relief costs in its financial statements. Subsequently, in 1991, the government voluntarily provided debt relief to Poland and Egypt. These arrangements will cost Canada more than $3 billion over the next 18 to 25 years and will use up a substantial portion of its allowance.

10.4 Given the uncertain global economic outlook, the possibility that additional debt relief may be required, and the fact that many organizations including the World Bank now recognize, quantify and account for losses associated with loans to sovereign states, the government needs to assess whether its current policy is appropriate and realistic. It also needs to assess, on an annual basis, the value of these loans.

10.5 Parliament needs better information on Canada's overall sovereign loan exposure and the costs associated with it. For instance, on the matter of the 1991 debt relief to Poland and Egypt, Parliament has been told only that the costs of these arrangements would be $542 million over the first two years.

Background

10.6 Canada extends credit to individual sovereign states for many reasons: to promote development, to support foreign policy objectives and to facilitate export trade.

Sovereign states owe Canada over $16 billion

10.7 At present, individual sovereign states owe Canada over $16 billion in loans (see Exhibit 10.1). Most of this credit — over $12 billion — was extended by two Crown corporations, the Export Development Corporation and the Canadian Wheat Board, to support export sales.

10.8 Both the Export Development Corporation and the Canadian Wheat Board finance their export sales to sovereign states by borrowing domestically and internationally, using the Government of Canada as guarantor. As the government guarantees this borrowing, in effect it assumes the risks and the costs if a sovereign state is unable to repay or if it delays repayment of its loans from the corporation. Thus, any costs associated with these borrowings are reflected in the government's financial statements.

10.9 Over $1.5 billion was also loaned to sovereign nations through the Canada Account to enable them to buy Canadian exports on credit. The Account is managed by the Export Development Corporation and is used to make loans for transactions deemed to be in the national interest, but for which the corporation is unable to extend credit because it has reached its maximum exposure ceiling for a single country or because a market is considered too risky. These loans are frequently offered on concessional terms — often interest-free with up to 40 years to repay after a 10-year grace period. Canada Account loans are funded from the Consolidated Revenue Fund and any concessional loans are fully expensed as a budgetary item in the year advanced.

10.10 Exhibit 10.2 provides information on Canada's overall loan exposure by country.

The decision to extend credit to a country is complex.

10.11 Each of the three vehicles that extend export credit has a separate procedure to establish credit limits. The Export Development Corporation establishes the credit limits on its corporate account. Credit limits for the Canadian Wheat Board and the Canada Account are set by the government after taking into account the advice provided by the Department of Finance and others. Credit limits to certain debtors have, on occasion, been increased by the government, not due to increased creditworthiness of the country but to accommodate accumulating unpaid interest. The Department of Finance monitors and assesses on an ongoing basis the activities of these three separate vehicles.

10.12 The decision to extend credit to a country is complex and entails consideration of a number of factors, including those related to foreign and domestic policy, such as the promotion of Canadian agriculture. The extension of credit to the former Soviet Union, and the subsequent decision to temporarily halt grain shipments to Russia,

Exhibit 10.1

Government of Canada Consolidated Sovereign Loan Exposure[1]
at 31 March 1992
(millions of $) (unaudited)

Government of Canada:	
Department of Finance	600
Canadian International Development Agency	2,350
External Affairs – Canada Account	1,570
Agent Crown Corporations: [2]	
Export Development Corporation	6,320[3]
Canadian Wheat Board	5,860
Total Consolidated Exposure	16,700

[1] Including accrued interest (booked and unbooked) on loans

[2] EDC and CWB are not consolidated in the Public Accounts

[3] Excluding provisions made for uncollectable loans

Source: Department of Finance

The government maintains that sovereign loans are considered ultimately collectable unless formally repudiated by debtor countries.

illustrate the range of issues and the complexity associated with such decisions (see Exhibit 10.3).

Audit Objectives and Scope

10.13 Our audit objective was to assess how the government recognizes and accounts for the risks associated with direct loans to sovereign states as well as those guaranteed by the government. We also assessed the adequacy of information presented to Parliament on all sovereign lending and on the various risks associated with these loans.

10.14 We concentrated on the $12 billion owed by sovereign states as a result of export credit sales through the Export Development Corporation and the Canadian Wheat Board. Although our audit required that we understand how loans are administered by these Crown corporations, we did not audit the corporations themselves.

10.15 Our audit focussed on the activities of the Department of Finance, which co–ordinates sovereign lending, and the Office of the Comptroller General, which, with the Department of Finance, is responsible for determining the accounting policies used in preparing the Public Accounts.

Exhibit 10.2

Aggregated Sovereign Loan Exposure[1], by Country, at 31 March 1992
(Consolidated EDC and CWB and Government of Canada)
(millions of $) (unaudited)

		$ Amount
1.	Poland	3,516
2.	Russia	1,712
3.	India	1,001
4.	Brazil	917
5.	China	771
6.	Algeria	706
7.	Egypt	702
8.	Pakistan	583
9.	Peru	531
10.	Mexico	495
11.	Other	5,766
		16,700

The top ten countries represent 65% of total loan exposure to sovereign states.

[1] Including accrued interest

Source: Department of Finance

Observations

Recognizing the Risks

10.16 Granting credit means accepting risks. In the case of loans to sovereign states, risks take the form of delays or non–payment of loan interest or principal. We would expect the government to regularly assess the risks associated with granting credit to sovereign states and to recognize the cost in its financial statements.

10.17 The government has traditionally maintained that a sovereign loan is considered ultimately collectable unless formally repudiated by the debtor.

10.18 Until the 1980s, when many debtor countries began experiencing repayment difficulties, it was generally believed that loans to sovereign states were always collectable. During the past decade, however, many creditors have recognized that, in fact, not all sovereign loans are collectable — that some loans may never be repaid in full and that repayment of others may be delayed indefinitely.

Rescheduling the debts of countries with repayment problems — the Paris Club

10.19 When a country finds itself in financial difficulty, it can seek to have its debts to sovereign states rescheduled through the Paris Club, the forum for rescheduling (restructuring) sovereign debt. The Paris Club, of which Canada is a member, is the group of creditor countries involved in these reschedulings. The Paris Club's policies are often influenced by the Group of Seven (G–7) industrialized countries (U.S., Japan, U.K., Germany, France, Italy and Canada).

10.20 Before a country can apply for debt rescheduling, the Paris Club requires that country to have in place an economic reform program that is supported by the International Monetary Fund.

10.21 Since it started in 1956, the Paris Club has always sought to preserve the value of sovereign loans when it reschedules them. Most reschedulings offer a grace period on principal repayments, with interest at market rates, thereby maintaining the present value of the loan. It was assumed that deferring repayment helps a debtor country by allowing time for development activities and for economic programs supported by the International Monetary Fund to bring the country back to a point where it can again service its debt.

Allowance for potential debt relief

10.22 In 1990 the government, anticipating debt relief initiatives, voluntarily set up an allowance in its financial statements "... in respect of potential debt relief or debt service relief measures for financially troubled countries under multilateral agreements."

10.23 In our view, the establishment of this allowance was, in effect, a recognition by the government that there are risks and potential reductions in the value of certain loans.

Rescheduling the debts owed to Canada by Poland and Egypt

10.24 According to the Department of Finance, in 1991, for geopolitical (as opposed to financial) reasons, the international creditor community through the Paris Club decided to embark on a process of voluntary debt relief for Poland and Egypt. The Department also advised us that this was an exceptional case.

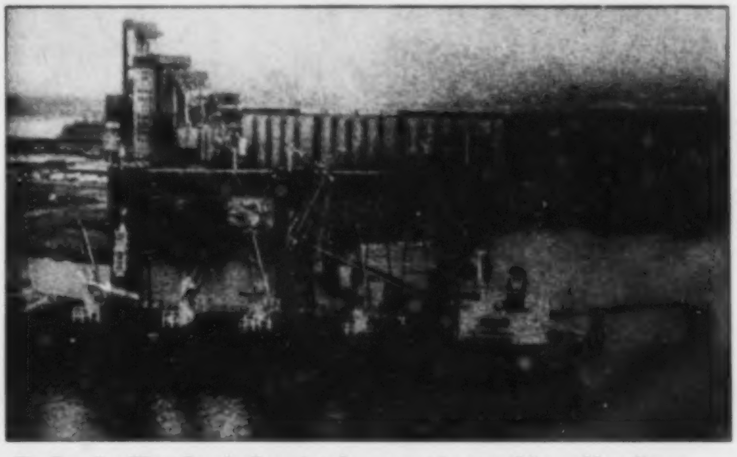
10.25 As its share of the undertaking, the Canadian government agreed to provide 50 percent debt relief on a present–value basis to Poland and Egypt, provided those countries meet the International Monetary Fund's targets for economic reform. Poland owed the Export Development Corporation and the Canadian Wheat Board approximately $3.5 billion, of which over $2 billion was unpaid interest; Egypt owed them $540 million. In addition, debt relief involving relatively small amounts had previously been offered to the world's poorest countries.

Debt relief to Poland and Egypt could cost Canadians over $3 billion in the next two decades

10.26 On behalf of Poland and Egypt, the Canadian government is paying the Export Development Corporation and the Canadian Wheat Board a portion of the interest payments due from those countries. This will reduce Poland's and Egypt's debts by half of their present value. Specifically, the government will pay a portion of the interest payments due for the 18 years of the agreement with Poland, and for 25 years in the case of Egypt. The Department of Finance has estimated that this will cost the government about $800 million over the first three years beginning in 1991, and $3.1 billion in total.

More debt relief may be needed

10.27 According to the World Bank, there are many countries whose prospects for a return to external viability



The Canadian Wheat Board sells grain to buyer countries around the world — often on credit (see paragraphs 10.11 and 10.12).

within a reasonable period of time are highly uncertain. The Paris Club is considering offering additional debt relief to low–income countries, and continues to examine the severely indebted lower middle–income countries on a case–by–case basis. Further debt relief may be necessary.

The government needs to adequately disclose to Parliament its total costs and commitment with respect to debt relief.

10.28 In the event that private sector financing proves to be inadequate, governments may also be called upon to increase their lending to the republics of the former Soviet Union.

10.29 On 16 June 1992, the Secretary of State for External Affairs said:

> "Trinidad terms (debt relief to the poorest countries) as they currently stand will cost Canada about $100 million. This is a cost we have agreed to bear. If we were to reduce the amounts owed by the poorest countries by 100 percent, the cost would be in the area of $250 million. We have said that we are prepared to move in this direction for countries who need more relief. As for the lower middle–income countries, debt reduction would have much larger costs — up to $1 billion, depending on the percentage of reduction and countries concerned. That is why in international discussions on this issue we have stressed that any reduction for these countries must be gauged on the basis of real need. *All debt reduction has cost associated with it. Forgiving official debt of all the developing countries with potential debt servicing problems would cost Canadian taxpayers well over $5 billion. This is far beyond what we can afford to do ...*" [italics added]

The government needs to examine whether its current policies for recognizing these risks are appropriate and realistic.

Will the allowance for debt relief be enough?

10.30 Using estimates provided by the Department of Finance, the debt reduction agreements with Poland and Egypt, together with debt reduction for the poorest countries, have committed a significant portion of the allowance. If interest rates rise, more of the allowance will be used. Finance has acknowledged that this allowance was intended to service only Poland, Egypt and the world's poorest countries, and that it remains adequate for that purpose.

10.31 As the Secretary of State for External Affairs has stated, other countries may also need debt relief. If offered, this additional debt relief may exceed the balance of the allowance.

10.32 The government's stated accounting policy with respect to the valuation of assets is: "Assets are recorded at cost and are subject to annual valuation to reflect reductions from the recorded value to the estimated realizable value." Because the government views sovereign loans as ultimately collectable, it sees no need to annually value its loan portfolio. We think the government should annually adjust its allowance for debt relief to recognize the changing financial risks in sovereign lending.

Is the present policy for recognizing risk still appropriate?

10.33 The Department of Finance maintains the position that the principle of the ultimate collectability of sovereign loans remains valid. Paris Club debt negotiations are based on the premise that liquidity problems are temporary and, if properly addressed, a country will ultimately be able to meet its obligations. The fundamental rationale underlying the approach of Canada and other creditors to rescheduling in the Paris Club, as stated by the Department of Finance, is to ensure that the net present value of rescheduled claims is not reduced.

10.34 However, according to a 1991 World Bank report, the Paris Club now accepts the need for debt rescheduling in certain circumstances, to help resolve problems of solvency as well as temporary liquidity problems. Debt relief may be necessary if certain countries experiencing repayment problems are to achieve external viability — the capacity to meet international financial obligations without further debt rescheduling or debt relief, while achieving satisfactory growth. Full external viability implies a return to creditworthiness, which is the ability to borrow on normal market terms.

10.35 Many financial institutions including the World Bank (see Chapter 12, paragraphs 12.65 to 12.71) and commercial banks now recognize and quantify the risks associated with sovereign loans.

10.36 Given this and the possibility of further debt relief, the government needs to examine whether its current policies for recognizing these risks are appropriate and realistic.

Information to Parliament

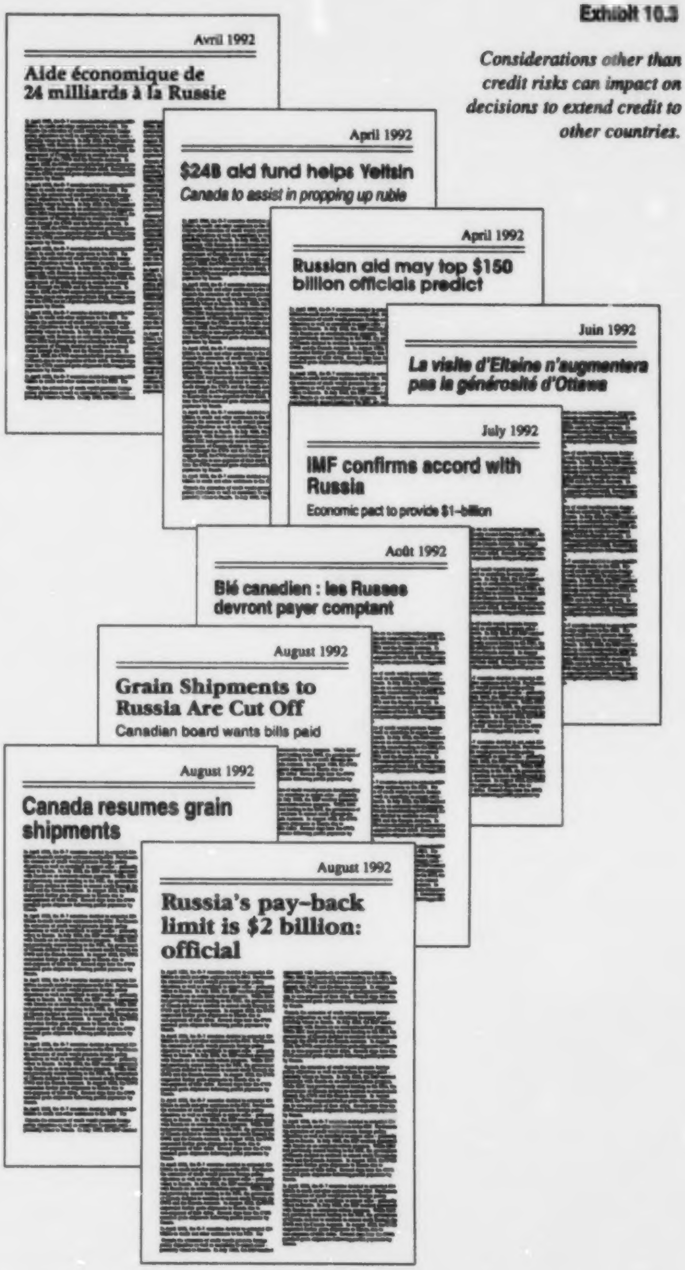
10.37 Information is provided to Parliament in several documents: the Budget, the Estimates and the Public Accounts. The information in these documents should be reliable, consistent, complete, relevant and understandable.

Better information on Canada's overall sovereign loan exposure is needed

10.38 Canada's sovereign loan portfolio is held by departments, agencies and Crown corporations. Because the activities of Crown corporations that lend to sovereign states are not included in the government's summary financial statements in the Public Accounts, the information Parliament receives in the Budget, Estimates and

Exhibit 10.3

Considerations other than credit risks can impact on decisions to extend credit to other countries.



Avril 1992
Aide économique de 24 milliards à la Russie

April 1992
$24B aid fund helps Yeltsin
Canada to assist in propping up ruble

April 1992
Russian aid may top $150 billion officials predict

Juin 1992
La visite d'Eltsine n'augmentera pas la générosité d'Ottawa

July 1992
IMF confirms accord with Russia
Economic pact to provide $1-billion

Août 1992
Blé canadien : les Russes devront payer comptant

August 1992
Grain Shipments to Russia Are Cut Off
Canadian board wants bills paid

August 1992
Canada resumes grain shipments

August 1992
Russia's pay-back limit is $2 billion: official

In April 1992, the G–7 countries decided to extend $24 billion in credit and other assistance to the former Soviet Union. For Canada the extension of credit would promote foreign policy objectives as well as contribute to export sales – primarily wheat to Russia. In March 1992, Cabinet considered the situation and confirmed a line of credit through the Canadian Wheat Board. In July 1992, the International Monetary Fund reached agreement with Russia on an economic reform program. In August 1992, the Canadian Wheat Board suspended further grain shipments to Russia due to non–payment of its debts. Later that month the Board resumed grain shipments, following partial payment by Russia.

Source: Various Canadian newspapers.

Public Accounts on sovereign loans is incomplete, in that there is no information on Canada's aggregate exposure, in total or on a country–by–country basis.

10.39 Parliament needs to receive meaningful annual reporting on Canada's international financial commitments. A meaningful report could include information on Canada's sovereign loan portfolio, including exposure by country, and on yearly activities including debt relief. It could also include information on the International Assistance Envelope and on Canada's participation in the International Monetary Fund, the World Bank and the other international financial institutions that extend loans to sovereign states.

Disclosure of debt relief reductions is inadequate

10.40 As described earlier, the government entered into major debt relief agreements with Poland and Egypt. Parliament, through the Estimates, has been provided with information on only the first two years of annual payments — $263 million in 1991–92 and $279 million in 1992–93.

10.41 We would expect the Part III of the Estimates to provide more information on debt relief and the cost of accepting these risks. For example, the following important information was not provided: the debt relief to Poland and Egypt has a present value of over $2 billion; and over a period of 18 to 25 years, an estimated $3.1 billion of the allowance will be used up as payments are made to the Export Development Corporation and the Canadian Wheat Board for debt relief given to these and other countries.

Conclusion

10.42 The government needs to review its current policies for recognizing and accounting for risks associated with loans to sovereign states to ensure that they are appropriate and realistic and that its financial statements adequately reflect the costs of these risks.

10.43 It also needs to provide better information to Parliament on its overall sovereign loan exposure, and adequately disclose its total costs and commitment with respect to debt relief.

***Department's response:** The Department of Finance disagrees with the fundamental premise of this chapter, which calls into question the ultimate collectability of loans to sovereign governments. The practice of all Paris Club creditors to international sovereign debt continues to be based on the principle of ultimate collectability. The agreed policies and practices of the federal government reflect this approach. The Department of Finance believes that this entire chapter is based on a false premise, and thus it is not possible to comment on the contents of the chapter on a paragraph–by–paragraph basis.*

Chapter 11

Canadian International Development Agency and the Regional Development Banks

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Canadian International Development Agency and the Regional Development Banks

Assistant Auditor General: Paul Ward
Responsible Auditor: Vinod Sahgal

Main Points

11.1 The government views multilateral co–operation as important to achieving Canada's foreign policy objectives. Promoting development is an integral part of these objectives. Canada's involvement with the regional development banks is a significant and growing aspect of multilateral co–operation.

11.2 Canada's cumulative financial assistance to the banks has risen from $2.6 billion in 1983 to $6.2 billion in 1991. Per capita, Canada contributes more than any other G–7 country.

11.3 Canada's purpose for participating in the regional development banks has been articulated in the International Development (Financial Institutions) Assistance Act.

11.4 CIDA, and Parliament, need better information to know how effective Canada's participation in the regional development banks has been in promoting the social and economic advancement of developing countries. CIDA is working with each bank to improve effectiveness evaluations. So far the results have been mixed. A study on the effectiveness of the banks is under way in Canada by the North–South Institute. CIDA, along with six other funders, is actively participating in this study.

11.5 The matters for which the Minister is accountable to Parliament need to be clarified. It is reasonable to expect that the Minister be able to: provide an account to Parliament of the overall results achieved through the regional development banks; justify, based on these results, the extent of Canada's participation in each bank; and account for the specific means employed to achieve Canadian objectives in these international institutions.

11.6 Certain aspects of Canada's management, accounting, control and reporting procedures need to be re–examined. We have four concerns:

- There is a need for CIDA to enhance its analysis of the quality of the banks' loan portfolios.
- The accounting treatment of the $391 million Canada has paid as capital to the banks needs to be reconsidered. There is, for example, no expectation of financial return on this "asset".
- Canada has committed $3.7 billion to the banks as unpaid subscribed capital — in essence, guarantees that support the banks' borrowings. There is no explicit approval by Parliament of these guarantees.
- The Public Accounts do not show as liabilities the $1.1 billion in notes payable for moneys committed to the regional development banks, despite Canada's legal obligation to pay. This accounting treatment needs to be reconsidered.

Introduction

11.7 Regional development banks are international financial institutions that Canada uses in co–operation with other nations to promote the social and economic advancement of developing countries. Multilateral co–operation is a key element in Canada's foreign policy, as we observed in Chapter 12 of our 1991 Report, and development assistance — a field in which Canada has been active for more than 40 years — forms a significant part of that co–operation.

11.8 The three main development banks referred to in this Chapter are the African Development Bank (AfDB) based in Abidjan, Côte d'Ivoire; the Asian Development Bank (AsDB), based in Manila, Philippines; and the Inter–American Development Bank (IDB), based in Washington, D.C.

11.9 Membership in the regional development banks is generally made up of developing countries in a particular region and industrialized countries of the world.

Background

11.10 Each regional development bank has both a "bank component" (the "Bank" or the "hard window"), which normally issues interest–bearing loans to developing countries that are at more advanced stages of economic development, and a concessional "fund component" (the "Fund" or the "soft window"), which makes concessional loans to the poorer developing countries. However, many developing countries borrow from both the bank component and the fund component of an institution.

11.11 The regional development banks obtain the funds for their "hard window" from three main sources: interest and fees on loans and investments, the money member countries pay to the banks in return for shares (the paid–in capital), and the money the banks borrow in the international capital markets. Member countries guarantee that borrowing through an unpaid subscription to the banks' capital, known as the "callable capital". The loans from the "soft window" are financed mainly through grants made by member countries (see Exhibit 11.1).

The government views multilateral co–operation as important to achieving Canada's foreign policy objectives.

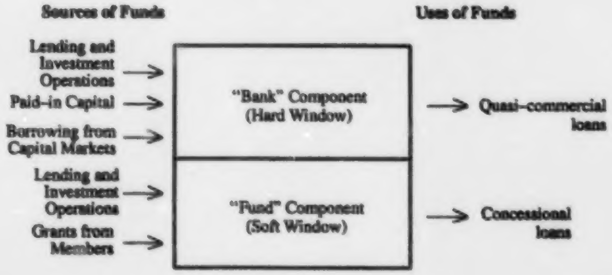
11.12 Assistance to developing countries by the African Development Bank, the Asian Development Bank and the Inter–American Development Bank has been growing. Loans outstanding totalled approximately US $53 billion at 31 December 1991 compared to approximately US $22 billion in 1985. In addition, undisbursed loans increased from US $22 billion in 1985 to US $32 billion at the end of 1991 (see Exhibit 11.2). An undisbursed loan is a loan that has been approved but not all disbursements have been made.

11.13 The regional development banks make the bulk of their loans for social and physical infrastructure projects in sectors like transportation, energy or agriculture. However, since the peak of the debt crisis in the mid–1980s, they have also been making policy–based loans — which can be disbursed more quickly than the traditional project–based loans —

Exhibit 11.1

Regional Development Banks Sources and Utilization of Funds

Regional development banks have two components. Each component obtains funds from different sources and makes loans at different conditions.


Sources of Funds
Uses of Funds
Lending and Investment Operations
Paid–in Capital
Borrowing from Capital Markets
"Bank" Component (Hard Window)
Quasi–commercial loans
Lending and Investment Operations
Grants from Members
"Fund" Component (Soft Window)
Concessional loans

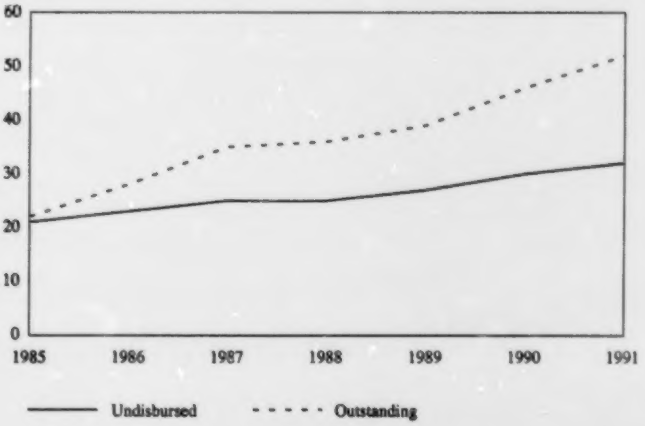
co–financed, in many cases, with the World Bank. Through this policy–based lending, they finance a borrower's "structural adjustment" — the term used for packages of economic assistance linked to policy reform in developing countries, designed to put a country on a path of sustainable growth and thereby help it meet its international financial obligations. The regional development banks also advise member governments on sectoral policy reform, and make "sectoral" or "policy" loans for that purpose.

11.14 Most of the money for both traditional project loans and policy–based loans goes to governments and state undertakings in the public sector, although assistance is also provided to the private sector.

11.15 Each bank is headed by a Board of Governors. Operating authority and responsibility for policy development is delegated by the Board of Governors to a full–time Board of Executive Directors. The Executive Directors meet regularly and normally make their decisions by consensus. If a vote is needed, voting power is weighted according to the size of a member country's contribution. As a member of the regional development banks, Canada accepts the principle of collective control by member states.

Exhibit 11.2

Regional Development Banks[1]
Loans Outstanding and Undisbursed
(in billions of U.S. dollars)



"Between 1985 and 1991, loans outstanding increased from US $22 billion to US $53 billion, and undisbursed loans grew from US $22 billion to US $32 billion."

[1] Including both the bank component and the fund component and excluding the Caribbean Development Bank/Fund

Source: Annual reports of the Banks

Canada's participation in the regional development banks is significant and growing

11.16 Like other members of the Group of Seven (G–7) largest industrialized countries, Canada is a member of all three regional development banks. Only the United States and Canada permanently have Executive Directors in all three banks. Per capita, Canada contributes more to the banks than any other G–7 country and its absolute share is often greater than that of the U.K., France, Germany or Italy. This seems to reflect the importance Canada attaches to multilateral co–operation.

11.17 The percentage of Canada's available budget that is allocated to international development assistance is a Government of Canada decision, as is the allocation of those funds between bilateral programs and multilateral programs. The government also decides the relative extent of Canada's participation in the World Bank Group and the regional development banks.

11.18 Canada's contribution to each regional development bank is influenced by a variety of economic, financial and foreign policy objectives, including development. Canada has adopted the practice of allocating enough money to each of the three banks mentioned in this chapter to ensure that it permanently retains a seat on the Boards of Executive Directors. Influence in an international organization is enhanced by having a seat on the Board.

11.19 The banks do not borrow more than the total value of the callable portion of the capital provided by the industrialized countries. This is important to credit–rating agencies because the creditworthiness of the guarantor countries is the main support for the banks' bondholders. Over the past 10 years, we estimate that approximately 11 percent of Canada's development assistance has been provided to the regional development banks in the form of payments for shares (paid–in capital), grants (the "fund component") and financial guarantees to back the borrowing of the banks in the world's capital markets (callable capital). It is important to note that this callable capital component is not considered part of Canada's official development assistance. During 1990–91 alone, Canada's assistance to the regional development banks amounted to approximately $640 million (see Exhibit 11.3).

11.20 Canada's cumulative financial participation in the three major regional development banks has risen from $2.6 billion as at 31 March 1983 to $6.2 billion as at 31 March 1991. This $6.2 billion consists of three elements (see Exhibit 11.4).

The Secretary of State for External Affairs is accountable for Canada's participation

11.21 Canada participates in the regional development banks under the authority of the International Development (Financial Institutions) Assistance Act (the IFI Act). This Act states that "the Secretary of State for External Affairs may, for the purpose of promoting the social and economic development of developing countries, provide financial assistance" to these institutions. The Secretary of State for External Affairs represents Canada on the Boards of Governors of the regional development banks.

11.22 The Department of External Affairs Act makes the Secretary of State for External Affairs the Minister responsible for CIDA, thereby bringing the Agency under that Act's broad authority.

11.23 In this chapter, accountability means the obligation of the Minister to account to Parliament for the means chosen to pursue the requirements of the Act and for the results Canada has achieved through the regional development banks.

11.24 As the Agency to which Parliament votes the funds, CIDA manages the payments to the three regional development banks and the guarantees of their borrowings. CIDA is the lead agency, but the departments of External Affairs and Finance also play a role. Finance acts as an advisor, at CIDA's request, on the financial matters pertaining to the banks. External Affairs is responsible for the conduct of Canada's foreign policy.

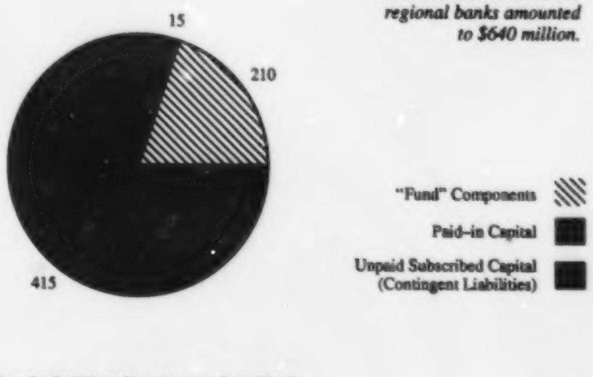
Development assistance is part of Canada's foreign policy

11.25 Canada's foreign policy provides the context for its development assistance policy. Canada's foreign policy framework stresses that many issues can be pursued only multilaterally and that current opportunities for multilateral co–operation provide the

Exhibit 11.3

Regional Development Banks[1]
Canada's Participation in 1990–91
(in millions of Canadian dollars)

In 1990–91 alone Canada's assistance to the regional banks amounted to $640 million.



(1) Excluding the Caribbean Development Bank/Fund.

Note: The unpaid subscribed capital is not considered part of Canada's official development assistance.

Source: Public Accounts of Canada, 1990–91

The primary purpose of Canadian official development assistance is to help the poorest countries and peoples of the world.

best potential for new forms of North–South co–operation, and for avoidance of further marginalization of the poor. In "Foreign Policy Themes and Priorities, 1991–92 Update", published by External Affairs in December 1991, the section entitled "Managing Interdependence" sets out as one of the government's overall objectives for development assistance to "improve the effectiveness of IFIs (International Financial Institutions) in reducing world poverty and in improving the environment".

11.26 External Affairs states that the regional development banks serve Canada's regional and global foreign policy objectives. They also allow the pursuit of Canada's objectives of "good governance", which include respect for human rights, commitment to democratic processes and institutions, sound economic management, appropriate levels of military expenditures, probity and transparency of public accounts, and priority for basic social programs. External Affairs also regards the projects funded by the development banks as sources of contracts for Canadian companies.

11.27 There is no specific enabling legislation that sets out CIDA's mandate and accountability for official development assistance. The 1987 document entitled "Sharing Our Future" outlines Canada's official policy on assistance to developing countries. The policy is based on four principles:

- The primary purpose of Canadian official development assistance is to help the poorest countries and peoples of the world.
- The aim is to strengthen the ability of people and institutions in developing countries to solve their own problems in harmony with the natural environment.
- Development priorities must prevail in setting objectives for the aid program. (The six priorities are poverty alleviation, structural adjustment, increased participation of women, environmentally sound development, food security and energy availability. These priorities are detailed in the document "Sharing Our Future".)
- Partnership is the key to fostering and strengthening the links between Canada's people and institutions and those of the developing world.

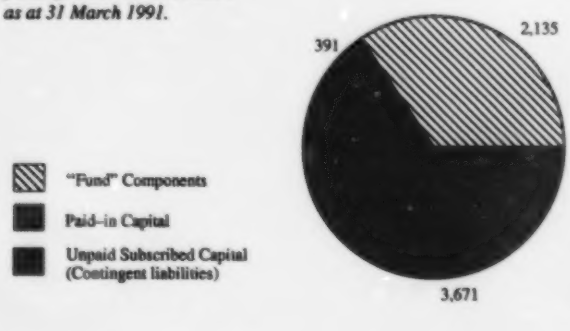
11.28 CIDA states in Part III of the 1991–92 Main Estimates: "For more than four decades, Canada has provided official development assistance to developing countries to help them to achieve sustainable development."

11.29 CIDA points out that the statements of goals, objectives and purposes of Canada's official development assistance need to be taken together from all the policy documents that set them out. These include "Foreign Policy Themes and Priorities, 1991–92 Update", "Sharing Our Future" and "To Benefit a Better World". There is no single document where one can find all the specific objectives that

Exhibit 11.4

Regional Development Banks[1]
Canada's Participation as at 31 March 1991
(in millions of Canadian dollars)

Canada's cumulative participation was $6.2 billion as at 31 March 1991.



(1) Excluding the Caribbean Development Bank/Fund

Note: The unpaid subscribed capital is not considered part of Canada's official development assistance.

Source: Public Accounts of Canada, 1990–91 the Minister has decided to pursue at the regional development banks. CIDA also points out that the government determines the policy direction pursued by the Minister.

11.30 CIDA informed us that the purpose of Canada's membership, shared by all members, is to support the institutions so that they can collectively play a stronger role in bringing about sustainable social and economic development in the borrowing member countries, and thereby solidify the international economic and financial system. In addition, Canada's role in the regional development banks is to ensure their integrity as prudent financial institutions and to promote their effectiveness as risk–taking, innovative development institutions.

Canada's role in the regional development banks is to ensure their integrity as prudent financial institutions and to promote their effectiveness as risk–taking, innovative development institutions.

Audit Objective, Scope and Approach

11.31 **Objective.** We conducted this audit with a view to helping Parliament scrutinize the activities, financial resources and results associated with the development assistance Canada provides through the regional development banks.

11.32 **Scope.** We focussed on how CIDA manages Canada's participation in the regional development banks to achieve the requirements of the IFI Act. The scope of our audit included both headquarters management at CIDA and management at the offices of Canadian Executive Directors at the three main regional development banks. We examined CIDA's stewardship of Canada's participation in the banks, in the context of current financial restraint and Canada's international commitments overall.

11.33 We did not examine management practices of the departments of Finance and External Affairs related to the objectives they too may be pursuing through Canada's participation in regional development banks.

11.34 **Approach.** We examined how CIDA assesses the development results of participating in the regional development banks. We also looked at whether the Agency communicates these and other results to Parliament in a way that permits public scrutiny and debate on the extent of Canada's participation in the banks and on their effectiveness as a channel for development assistance.

11.35 We reviewed official documents made available by the banks on financial and operational matters, and examined reports published by the banks and other organizations. We also looked at official and public documents on CIDA's activities, as well as studies in the field of international development. We visited the headquarters of the three regional development banks. We interviewed officials of CIDA, other departments and the banks, including the Canadian Executive Directors. Finally, we reviewed two of the main reports CIDA uses to account to Parliament for its activities and spending: Part III of the Main Estimates and the Public Accounts of Canada.

11.36 CIDA's Audit and Evaluation Division had not carried out any recent internal audit of Canada's participation in the regional development banks, nor evaluated how effectively the Agency manages that participation. Accordingly, we could not review the work done by the Division.

11.37 Unlike the external auditors of some other international organizations, like the United Nations, the external auditors of the regional development banks do not have the mandate to do performance audits on behalf of the banks' shareholders and, consequently, have not carried out such audits. Their mandate is limited to an annual examination of the banks' financial statements. Consequently, in developing our observations we could not review the work of these external auditors.

Observations and Recommendations

How Effective Are the Regional Development Banks?

11.38 The IFI Act states that "the Secretary of State for External Affairs may, for the purpose of promoting the social and economic development of developing countries, provide financial assistance" to the regional development banks.

CIDA, and Parliament, need better information to know how effective the regional development banks are in achieving Canada's objective to promote social and economic advancement in developing countries.

11.39 It is important that parliamentarians have available clearly articulated objectives for Canada's participation in the regional development banks. These should be presented in a readily understandable format, preferably in one document. Parliament can then hold CIDA to account for its stewardship of Canada's participation in the banks. The IFI Act provides CIDA with a basis for developing these objectives and for measuring and reporting on effectiveness.

11.40 There are two related considerations in assessing the effectiveness of the regional development banks: the extent to which they promote development in borrowing countries and the degree to which they operate as viable financial institutions.

11.41 We examined how CIDA monitors the following three related matters: first, how well Canadian objectives have been achieved through CIDA's participation in the regional development banks; second, to what extent Canada's desire to promote sound management practices, including financial viability, is being pursued; and third, what information on effectiveness is provided to Parliament.

Effectiveness measurement is under way

11.42 There is high inherent risk in implementing most development projects. Regular monitoring and periodic assessment of projects, programs and organizational performance can provide important lessons for decisions about policy, future programs and projects. The Secor Report, an internal study on CIDA's management, notes that evaluation "can also play a critical strategic role in ensuring the credibility of aid agencies and in legitimizing development assistance vis-à-vis various constituencies. This is because evaluation can provide evidence that aid is really effective in achieving practical solutions to development problems." The methodology for evaluating development results is evolving rapidly.

11.43 The extent to which regional development banks give CIDA systematic evaluations of continuing benefits, on either a sector or project level, has been uneven. CIDA is working with each bank to improve the quality of evaluations. So far, the results have been mixed.

11.44 An overall study on the effectiveness of the regional development banks is under way by the North–South Institute. CIDA is actively participating in this study along with six other external funders, whose objectives include assessing how well the banks have diagnosed the problems of developing countries, how effectively they have tackled them and how successful the banks are as "development agencies". The Institute notes that the World Bank and the three main regional development banks "emerged during the 1980s at the forefront of new trends in thinking about development and in assisting developing countries. Yet, astonishingly little research has been done on these agencies, particularly the regional development banks. The purpose of this project is to make a contribution to understanding about their role and effectiveness as agencies of development in the increasingly turbulent and uncertain decade of the 1990s." The Institute will also examine why Canada participates in these institutions and what results are achieved. The study began in 1991 and the report is scheduled to be published in mid–1993.

CIDA is promoting sound management practices

11.45 In 1989, CIDA identified significant management issues affecting Canada's participation in the regional development banks. In 1990, it developed recommendations to deal with these issues and took action on each. Canada's concerns about the banks' management practices and policies have been brought to the attention of bank management.

11.46 Canada and other member countries have made progress in promoting sound management practices at the banks and enhancing their financial viability. This helps protect the banks and their shareholders against a call on capital. Regional development banks have been encouraged to maintain adequate levels of liquidity; two of the three banks have increased their provisions for loan losses (the highest now being at 3 percent of its total loan portfolio) and the third reportedly has undertaken to do so. CIDA has developed a framework to monitor the financial viability of the banks. We are encouraged to see that CIDA is now taking the next step and using a framework to systematically assess the ongoing financial viability of these institutions. CIDA informed us that it is establishing a process to periodically carry out such assessments. However, we have two remaining concerns. They are covered in paragraphs 11.65 to 11.85.

Canada and other member countries have made progress in promoting sound management practices at the banks and enhancing their financial viability.

Reporting is needed on effectiveness

11.47 It is important that policy makers and legislators be made aware from time to time of the development results that are being achieved. If the results are significantly different from those originally anticipated, this fact and its implications need to be determined and reported clearly to Parliament. At the World Bank there is ongoing review of projects in difficulty. That bank recently conducted a systematic study of some 1,015 development projects, which among other things assessed the extent of bias toward overestimating the expected rate of return during project appraisal. At issue is whether and how the regional development banks are addressing these kinds of questions.

11.48 CIDA could extend the information it provides to Parliament to include how effective it thinks the regional development banks have been in meeting Canada's objectives and priorities for its membership, and how Canadian managers assure themselves of the integrity of the regional development banks as prudent financial institutions. A demonstration of what Canada has achieved at the regional development banks and has learned from the past, as well as an explanation of the specific management improvements under way, would be helpful for parliamentarians. CIDA should also disclose any difficulties or constraints that it believes limit its ability to provide this information. That type of disclosure would make clear the limits, if any, of effectiveness measurement and of a single member's influence at the institutions.

11.49 CIDA should periodically assess and report on how Canada's objective of promoting social and economic development in developing countries has been achieved through the regional development banks.

***CIDA's response:** CIDA agrees that the objectives and results of Canada's participation in the regional development banks need to be clearly stated and the Agency has been working to improve its performance in this regard. The Agency will continue to improve its current reporting through existing documents such as the Part III of the Main Estimates and through testimony in parliamentary committees. The* *current North–South Institute evaluation of the regional development banks, which is sponsored and funded by CIDA, will assist CIDA in this improvement.*

Clarifying Accountability

The matters for which the Minister is accountable to Parliament need to be clarified

11.50 Canada is only one of many members of the regional development banks; in these international organizations, decisions are taken on a collegial basis. CIDA accepts the responsibility for providing, with other countries, the means — money, personnel and policy advice — for these institutions to help poorer countries achieve social and economic development. CIDA also states that it is responsible for assessing the effectiveness and efficiency of funded institutions through appropriate evaluation activities.

CIDA states that it is responsible for assessing the effectiveness and efficiency of funded institutions through appropriate evaluation activities.

11.51 Accountability for results of individual programs or projects rests with the Boards of the institutions. The extent of accountability for overall results, and the related reporting responsibility, are not articulated in the IFI Act. Consequently, nor is the extent to which the Minister could reasonably be expected to account for the overall results of Canada's participation in the banks. Accountability for two other matters also needs clarification: for justifying the extent of Canada's participation and for the means employed to achieve Canadian objectives in these international institutions.

11.52 Clarifying accountability would also help define what should be reported periodically to Parliament. CIDA has recently taken an initial step to more clearly define its accountability framework by preparing a document entitled "CIDA Accountability" and by holding related discussions with central agencies. We believe CIDA should take the next step to obtain parliamentary approval of the accountability framework it believes is appropriate for the Agency.

11.53 CIDA should seek a clarification from the appropriate authority, possibly through legislation, of what the Minister can reasonably be asked to account for in terms of the means and the results associated with Canada's participation in the regional development banks.

CIDA's response: The Agency is currently in conformity with the IFI Act and provides information to parliamentarians through Part III of the Main Estimates, the Public Accounts of Canada, parliamentary committees and responses to direct inquiries. It is not for CIDA to determine if amendments to existing legislation should be sought.

Certain Management, Accounting and Control Procedures Need Re–examination

11.54 In recent years, there has been a significant shift in the composition of the total debt owed by developing countries; official creditors (sovereign states and international financial institutions) have taken over from private creditors (commercial banks and other private sources) as the main source of new lending for the developing world. Financial exposure in the regional banks is growing. Over the last ten years, many developing countries have experienced difficulties in servicing their external debt. It may take a long while for the creditworthiness of many borrowing countries, especially in Africa, to improve in a sustainable way. Uncertainty about the creditworthiness of many developing countries remains evident. In such an uncertain environment, prudence is generally recommended.

11.55 In our opinion, prudence would suggest that certain aspects of Canada's management, accounting and control procedures need to be re-examined. First, the regional development banks should be encouraged to conduct periodic assessments of the quality of their loan portfolios. Further, CIDA could strengthen its assessment as to whether Canada's practice of not recognizing any cost associated with maintaining the preferred creditor status of the banks is, indeed, appropriate. Second, the accounting for Canada's financial participation in the banks needs to be reconsidered. Finally, there is a need for better control over Canada's subscriptions to the unpaid capital of the banks; a mechanism should be established for Parliament to approve these contingent liabilities before they are made.

Financial exposure in the regional banks is growing

11.56 Sovereign debt of the developing countries has been rising. The total debt the developing countries owe to industrialized countries is now 13 times what it was 20 years ago: it rose from about US $100 billion in 1970 to about US $575 billion in 1980 and to US $1,280 billion in 1990, before adjusting for inflation. Arrears on this sovereign debt have also been rising, increasing from US $40 billion in 1986 to US $111 billion in 1990. In the past ten years, official creditors have taken over from private creditors as the main source of new lending for the developing world. The World Debt Tables indicate that the proportion of the total long-term debt that developing countries owe to official creditors has increased significantly — from 37 percent in 1980 to slightly over 50 percent a decade later. Projections indicate that this shift could continue.

11.57 More and more of the new debt is owed to multilateral institutions. In 1980 the multilateral development banks held 11.5 percent of the long-term debt owed by developing countries. Ten years later this stood at 20 percent.

11.58 Among the multilateral lending institutions, the regional development banks are taking a larger share of the net disbursements. They accounted for 15 percent of the net multilateral disbursements in 1982. By 1990, their share had risen to 22 percent.

11.59 Canada's financial exposure in the regional banks is also growing. As indicated in paragraph 11.20, Canada's cumulative participation in the three regional banks has increased from $2.6 billion in 1983 to $6.2 billion in 1991.

Uncertainty about the creditworthiness of some countries remains evident

11.60 The regional development banks are often lenders of last resort, making loans almost exclusively to governments and state undertakings of developing countries. The international capital markets view this area as highly risky, a view reflected in their interest rates. Risk is inherent in the lending operations of the development banks. Developing countries borrow from these banks at lower interest rates than those charged in the international capital markets. The difference between the two interest rates represents the market's evaluation of the risk in lending to certain sovereign states.

The creditworthiness of many sovereign states remains a matter of concern.

11.61 The creditworthiness of many sovereign states remains a matter of concern. A substantial portion of the loan portfolios of two of the regional banks is made to countries that have rescheduled some of their debts. The ability and willingness of these countries to service outstanding external debt has not consistently improved in a timely and sustainable way, despite debt relief and, in some cases, stringent reform packages initiated by the International Monetary Fund (IMF). Implementing structural adjustment — economic assistance in exchange for policy reform — takes time. This is particularly true of many borrowing countries in Africa and, to a lesser extent, of certain countries in Latin

America and Asia. Although the economic performance of a growing number of developing countries has been improving, some experts believe that the structural adjustment programs of the World Bank and the IMF are not in themselves sufficient. Additional debt relief, more trade and "good governance" are just as important, as are further investments in health, education and population control.

The long–term cost of some infrastructure projects is now likely to be higher than expected because certain costs, such as those of protecting the environment, were underestimated.

11.62 The long–term cost of some infrastructure projects is now likely to be higher than expected because certain costs, such as those of protecting the environment, were underestimated when the project loans were approved. More important, a significant proportion of recent loans made by the regional development banks are structural adjustment loans, intended to put a country on a path of sustainable growth, thereby helping it meet its international financial obligations.

11.63 The IMF has recently pointed out that "The developing world would appear to be at a critical juncture: **if** the reforms take hold, and the external environment is favourable, the rest of the decade could see sustainable growth in per capital GDP; on the other hand, **if** reforms are not sustained, and **if** stabilization policies are relaxed prematurely, growth is likely to remain elusive" (emphasis ours).

11.64 How is CIDA adapting its management, accounting and control procedures to the uncertainty in its environment?

The quality of loan portfolios needs monitoring

11.65 The regional development banks are not immune to the global debt problem. Although it is true that the regional banks are acknowledged as preferred creditors, and that the risk of default by borrowing countries is therefore relatively low, there have been cases of prolonged arrears. The preferred creditor status of the regional development banks is not based on a formal or legal subordination of the debts owed other creditors to the debts owed to the banks. It is based on informal factors, like the willingness of the development banks to maintain a positive cash flow to their borrowing countries. One must ask whether these flows can be maintained indefinitely.

11.66 Maintaining the preferred creditor status of the regional development banks is not cost free to countries like Canada. The costs show up indirectly when debt relief becomes necessary, normally through the Paris Club (see Chapter 10). Moreover, pressure to provide fast–disbursing loans and loan guarantees to relieve balance–of–payment difficulties, linked with the reform packages initiated by the IMF, has been mounting — even in Asia, which is otherwise considered a relatively good credit risk area. Not surprisingly, the outstanding external debt in most developing countries has risen significantly in the last ten years.

11.67 CIDA points out that the preferred creditor status accorded to the regional development banks by borrowers is in the borrowers' interest. Unlike commercial banks, the regional development banks are willing to lend to borrowing members in good standing provided that loan conditions are met and upon approval by their Boards. In other words, in their capacity as development institutions, the regional development banks do not impose credit rationing on strictly commercial grounds, as commercial banks do. This willingness to lend (under stringent performance conditionality), even to borrowers whose creditworthiness has been impaired, is certainly a factor in the banks being accorded preferred creditor status. At the same time, maintaining status as a member in good standing with the banks (which means they are following sound economic and financial policies carefully assessed by professional staff of the banks) arguably is even more valuable to the borrowers for preserving their credit standing in the international financial community as a whole. It is the value attached to this standing that is important in assessing why borrowers accord preferential creditor status to the regional development banks.

11.68 CIDA also points out that creditworthiness of many borrowers — that is, their capacity to service their debt — has recently improved. However, the creditworthiness of some heavily indebted countries in Africa is not likely to improve dramatically in the near future.

11.69 In view of the significant financial exposure at the regional development banks and uncertainty about the creditworthiness of many developing countries, we expected CIDA and the Canadian Executive Directors, as stewards of Canadian participation, to have available an analysis of the credit risk associated with the banks' loan portfolios as a basis for judging the quality of the portfolios.

11.70 The changing environment makes it vital that member countries like Canada urge the regional development banks to continually monitor the quality of their loan portfolios. This is just as important as the need for rigorous, unbiased systematic evaluations of funded projects.

11.71 A periodic analysis of sovereign risk (the credit risk of lending to sovereign states) helps identify the risk of financial loss inherent in the current loan portfolio. The results of this analysis could be incorporated into the loan appraisal process.

11.72 The World Bank conducts such analysis of the quality of its loan portfolio. It recently concluded that one third of the portfolio was in countries that are viewed as high risk, where severe financial pressures may cause them to fall into arrears to the bank. Further, it reported that the quality of the portfolio has deteriorated since 1980 and that this deterioration may continue. Trends like these must be watched, assessed for their causes and, where possible, corrected. This is an important responsibility of this bank's Board of Executive Directors.

11.73 The Executive Directors told us that the regional development banks had not yet undertaken systematic risk analyses of borrowing countries. CIDA, in conjunction with the Canadian Executive Directors, needs to enhance its analysis of the quality of the banks' loan portfolios. CIDA officials cautioned us against drawing conclusions based on country risk analyses done by independent sources such as export credit agencies, which may also lend to these same developing countries, because each institution's loan portfolio has different characteristics.

11.74 We agree with CIDA that there is no substitute for country–risk analysis by each institution. The financial viability of the banks cannot be systematically assessed without such analysis. We encourage CIDA to insist that the regional development banks carry out periodic country–risk analyses; there is a need to continually watch for unfavourable trends in changes to the quality of their loan portfolios.

The changing environment makes it vital that member countries like Canada urge the regional development banks to continually monitor the quality of their loan portfolios.

11.75 CIDA, in concert with other countries, should urge the regional development banks to carry out systematic analyses of their loan portfolios based on the sovereign risk of individual borrowers.

CIDA's response: *CIDA believes that the financial integrity of the regional development banks is critical if those institutions are to remain effective development institutions, and if Canada's investments are to be safeguarded. Levels of reserves and loan loss provisions are fundamental to this objective and are factored into account in the financial viability framework developed by CIDA to monitor each institution and to facilitate*

Canadian interventions in regular bank discussions of financial policies.

The Agency, in consultation with the Department of Finance and the Department of External Affairs, will urge, through its Executive Directors, the regional development banks to make improvements in the area of comprehensive analyses of the quality of the banks' loan portfolios. The Agency has been urging, along with other donors, that the banks review the quality of the loan portfolios. The banks have responded and recently have started to perform these analyses.

There is a need to assess the full cost of maintaining the regional banks' preferred creditor status

11.76 Together with a bank's other reserves, loan loss provisions are a first line of defence for member countries should any of the bank's larger borrowers default. Such prudent financial management and accounting practices reduce the likelihood that a bank would experience significant financial losses that would necessitate additional financial support from member countries.

Periodic analysis of sovereign risk helps identify the risk of financial loss inherent in a bank's current loan portfolio.

11.77 As we have noted, a periodic analysis of sovereign risk helps identify the risk of financial loss inherent in a bank's current loan portfolio. The results of this analysis could also be used in determining the level of provisioning for losses on loans that is necessary for fair presentation in financial statements.

11.78 The lending environment in which the regional banks operate and the creditworthiness of their borrowing countries are now acknowledged by the banks in their financial statements. As pointed out in paragraph 11.46, two of the regional banks have increased their loan loss provisions. The other bank included in this audit, which has never before made a provision for loan losses, is reportedly considering incorporating such provision in its financial statements.

11.79 In determining the size of the loan loss provision it considers necessary to reflect the collectability of its sovereign loan portfolios, the World Bank takes into consideration the amount of future financial support its shareholders would likely accord to countries the Bank considers to be high risk. This support takes the form of bilateral debt relief, additional financial support — including bridge financing — toward clearing the arrears to multilateral development banks, and cash transfers linked to the International Monetary Fund and the World Banks's structural adjustment programs. Additional financial assistance from multilateral sources through similar support programs is also taken into account.

11.80 The regional development banks have implicitly recognized the importance of such future shareholder financial support by adopting a similar approach. Canada, though, has not recognized any amount of this future support in its own books of account. An important question for Canada and other member countries is, what would the banks' level of provisioning be without such additional support from their shareholders? The answer to this question would allow member countries to assess the cost, if any, of maintaining the preferred creditor status of these institutions.

11.81 An assessment of the loan loss provisions, from a member country's perspective, would provide CIDA with greater assurance that Canada's practice of not building up a provision for the cost associated with maintaining the regional banks' preferred creditor status is, indeed, appropriate.

11.82 We expected CIDA to be fully aware of the methodology for making loan loss provisions at each bank.

11.83 We asked CIDA, as the lead Agency accountable to Parliament for monitoring the financial viability of the banks, to describe to us how it assures itself that the loan loss provisions at the regional development banks are adequate from a member country's perspective — in other words, whether and to what extent the methodology for loan loss provisions takes into account additional financial support from member countries.

11.84 At the time of our audit, CIDA could not demonstrate the link between the inherent risk in the banks' loan portfolios and the appropriateness of Canada's practice of not building up a provision for the cost of maintaining the preferred creditor status of the banks.

11.85 We believe CIDA could strengthen its knowledge and assessment of the loan loss provisioning methodology used by the regional development banks. CIDA would then be in a better position to advise the Department of Finance on the continuing appropriateness of not building up a provision for the cost of maintaining the banks' preferred creditor status.

Accounting and control procedures need to evolve

11.86 The government's accounting policies require that liabilities be recorded when incurred and assets recorded when acquired. In addition, assets such as loans, advances and investments must be re–examined periodically to ensure that they are fairly presented in the financial statements. Normally, this kind of check is conducted by each department or agency at least once a year. As the Agency most knowledgeable about the workings of the regional banks, CIDA is in the best position to identify any need for accounting changes and has a duty to point them out. If the President of the Treasury Board and the Minister of Finance agree, the changes are implemented and appear in the Estimates and the Public Accounts of Canada.

11.87 The accounting policies also require that all contingent liabilities, such as the subscriptions to the callable capital of the banks, be noted annually in the Public Accounts.

11.88 The Canadian Institute of Chartered Accountants (CICA) guidelines for the accounting of government transactions pay specific attention to transfer payments like those made to the "fund component" of the regional banks.

11.89 These guidelines cover how and when transactions should be recorded in the books of an entity such as Canada, and how they should be presented in the government's financial statements.

11.90 We took the above factors into consideration in examining the accounting and control procedures as they apply to Canada's financial exposure at the regional banks.

11.91 Structural adjustment loans represent a significant proportion of recent loans made by the regional development banks. This is evidence of a fundamental shift in the nature of the regional development banks themselves, from a more traditional role as banks to an increasing role as development policy agencies. In view of this shift, and given Canada's growing financial exposure, the highly uncertain environment, and the lack of adequate information on the quality of each institution's loan portfolio, prudence is recommended in choosing the control procedures and the financial accounting conventions that Canada should now use to record its involvement in the regional development banks. In this context we have three concerns about the existing accounting and control procedures.

Structural adjustment loans represent a significant proportion of recent loans made by the regional development banks.

Accounting for Canada's paid–in capital to the regional development banks needs to be reconsidered

11.92 The accounting treatment of Canada's paid–in capital to the regional banks needs to be reconsidered.

Canada treats as an asset, without any impairment in its value, the $391 million it has paid as capital to the banks. This is despite the increasing recognition that sovereign lending is not risk free. CIDA states that the paid–in capital reflects a claim on the assets of the banks, and that it is a sound investment on which member countries earn income that is retained by the banks in the form of reserves. We note that there is no financial return expected by Canada from this "asset", and that Canada's paid–in capital will likely remain in the banks for many years to come. The regional development banks were never intended to be self–sustaining financial institutions. They depend on member countries like Canada for ongoing financial assistance. A similar situation exists with respect to the $330 million Canada has paid as capital to the World Bank. In both cases, the rationale for carrying these as assets at full value needs to be reconsidered.

11.93 CIDA, in consultation with the Department of Finance and the Office of the Comptroller General, should reconsider the accounting treatment of the paid–in capital of the regional development banks.

CIDA's response: *CIDA has reviewed this issue with the Office of the Comptroller General and we are in agreement that the current accounting treatment is appropriate. Paid–in capital is used by the development banks to make loans to developing countries. As these investments are essentially a flow–through mechanism for Canada and other countries to make loans to sovereign states, it is our position that the government's valuation policy for sovereign loans also applies to these subscriptions. They are viewed as collectable unless formally repudiated by the debtor countries.*

Parliament may want to consider the need to approve the unpaid subscriptions to the capital of the regional banks

11.94 The IFI Act gives the Secretary of State for External Affairs unlimited authority to commit Canada to purchase shares in the regional development banks without going first to Parliament for approval. In 1989, for instance, the authority of section 3 of the Act was used to commit Canada to subscribing to unpaid shares in the Inter–American Development Bank worth more than $1 billion. This commitment was not specifically approved by Parliament, although Parliament has been informed of the extent of this contingent liability through the Public Accounts of Canada.

Canada has committed a total of $3.7 billion in unpaid subscribed capital to the regional banks.

11.95 When section 3 of the IFI Act was drafted, Canada's involvement in the regional development banks was not as significant as it is today. However, the scale of Canada's participation and the attendant sovereign risk — current and potential — have grown dramatically since 1983. Canada has committed a total of $3.7 billion in unpaid subscribed capital to the regional banks. These unpaid subscriptions (shown as contingent liabilities in the Public Accounts of Canada) may have financial implications for Canadian taxpayers in the future, because they are guarantees that support the borrowings of the banks. We are concerned that there is no mechanism for Parliament to approve these financial commitments. In our opinion, the appropriateness of making financial commitments of such magnitude without explicit parliamentary approval needs to be reconsidered, with a view to improving parliamentary control.

11.96 CIDA should seek amendments to the International Development (Financial Institutions) Assistance Act that would require the Minister to obtain the approval of Parliament before financial

commitments are made to the unpaid capital subscription of the regional development banks.

CIDA's response: The Agency proposes to disclose through vote wording the financial commitments for the unpaid capital subscriptions of the regional development banks made pursuant to the IFI Act. It is not for CIDA to determine if amendments to existing legislation should be sought.

Accounting for the legal obligation to make future cash payments to the Funds needs to be reconsidered

11.97 Demand notes to the regional development banks — notes payable of $1.1 billion at 31 March 1991 — are shown on the government's statement of assets and liabilities as a reduction in the government's investment in the banks rather than as liabilities. Since 1 April 1986, note encashments ($159 million in 1990–91) are made under budgetary authority, whereas notes issued to the banks ($229 million in 1990–91) continue to be made under non–budgetary authority. The net investment in the regional development banks — the investment, reduced by budgetary expenditures since 1986 and by notes payable — is included in the government's allowance for valuation of assets.

11.98 The deposit by Canada of the demand notes to the Funds signifies an acknowledgement of Canada's obligation to pay. At the time of issuance the notes represent resources of the Funds. They are immediately available for conversion to the Funds' loans receivable. The issuance of the notes by Canada establishes Canada's liability and in turn allows the Funds to immediately make further loans and grants to developing countries. Accordingly, we hold the view that a significant economic event occurs when Parliament approves the issuance of the demand notes, and at that point Canada has met all the terms of the commitment previously made by the Minister. To not recognize the issuance of the notes as a reduction of the resource base of Canada would appear to be inappropriate. These resources cannot belong to both Canada and the Funds at the same time. We therefore believe that notes payable to the regional development banks should be shown as liabilities on the government's balance sheet rather than being netted against the investment in the banks. Further, the related expenditures should be recognized, in an appropriate manner, at the time they are incurred. One view is that it would be appropriate to recognize the expense and the increase in the deficit when the notes are issued rather than waiting until they are encashed.

11.99 CIDA has a different view of this matter. CIDA believes that including the notes in the deficit when they are encashed matches the cost to Canada more closely with the development benefits received. For example, the agreement for replenishing the Inter–American Development Bank's Fund for Special Operations explicitly states that the notes will be encashed according to a ten–year schedule to be established by the Board of Executive Directors. This schedule will match anticipated disbursements of loans approved. Although they are labelled "notes payable", CIDA argues that these notes actually represent only a commitment by Canada over a long period of time and, consequently, they should not be included in the deficit when issued.

11.100 On this matter, the CICA's pronouncement on "Accounting for Government Transfers" states that "government transfers should be recognized in a government's financial statements as expenditures or revenues in the period that the events giving rise to the transfer occurred, as long as: (a) the transfer is authorized; (b) eligibility criteria, if any, have been met by the recipient; and (c) a reasonable estimate of the amount can be made." Judgment is required to account for transfers in a manner that represents the substance of the underlying events rather than the form or funding pattern. The Treasury Board's technical requirements for identifying, quantifying, recording and reporting liabilities are consistent with this pronouncement.

11.101 Subscriptions to the "fund component" of the regional banks appear to meet these criteria at the time the demand notes are issued.

11.102 CIDA, in consultation with the Department of Finance and the Office of the Comptroller General, should reconsider, and revise as appropriate, its accounting for and reporting of notes payable to the regional development banks.

CIDA's response: *CIDA has reviewed this issue with the Office of the Comptroller General and we are in agreement that the current accounting treatment is appropriate. These notes payable are commitments to the development banks and not liabilities. They are an agreement to make payments over a scheduled future period, which in turn is used to establish project schedules. Consequently, the matching of costs with benefits, or outputs, should occur when the notes are encashed and not when they are issued.*

A Need for Checks and Balances

CIDA needs to involve its Finance and Corporate Information Branch and its Audit and Evaluation Division

11.103 Despite Canada's significant and growing financial exposure at the regional development banks, CIDA told us it does not expect its Finance and Corporate Information Branch or its Audit and Evaluation Division to help in managing Canada's participation in the banks.

11.104 We believe that at least one of these units could be monitoring, independently of program management, the way the risks and benefits associated with Canada's participation in the regional development banks are periodically assessed, and could periodically look into the appropriateness of the accounting for that participation. This would strengthen the checks and balances in the management process.

Parliament Needs to Know the Risks and Benefits

CIDA should provide better information

What is needed is better, more relevant information. The information submitted to Parliament should be of a "strategic" nature.

11.105 CIDA could enhance its reporting to Parliament on its stewardship of Canada's participation in the regional development banks. What is needed is better, more relevant information. The information submitted to Parliament should be of a "strategic" nature. This might include such items as the development returns for the banks' main borrowers; the value to Canada of permanently retaining a seat on the Board of every regional development bank; and the value of using these institutions to the extent Canada does, instead of using other channels for multilateral or bilateral development assistance. Any significant change in Canada's financial exposure and risk could also be reported.

11.106 Three main published documents tabled each year disclose information on the regional development banks: Part III of the Estimates, the Public Accounts of Canada and CIDA's annual report. Members of Parliament can also obtain information on regional development banks in several other ways: directly from CIDA; through the hearings and special reports of parliamentary committees; from visits to the institutions; and, in some cases, by participating as representatives of Canada at the annual meetings of the banks.

11.107 Our audit concentrated on the formal, publicly accessible documents and the IFI Act. We reviewed these documents to assess whether each meets its main purpose with respect to the information it reports on Canada's participation in the regional development banks.

11.108 Parliament's ability to scrutinize effectively the value obtained from Canada's participation in the regional development banks can be enhanced. Many items need better disclosure. These include the specific objectives for Canada's participation in the banks, the extent of its financial exposure and the net benefits derived. We believe that periodic assessment and disclosure of results could lead to a more discernible portrayal of the net benefits. We recognize that such assessments cannot be done in a purely quantitative or precise terms.

11.109 Three areas need improvement: CIDA's Part III of the Main Estimates, CIDA's input in the Public Accounts, and the IFI Act.

Reporting to Parliament: improving CIDA's Part III of the Estimates

11.110 Part III of the Main Estimates is intended to indicate, for each program activity, the results expected for the money spent. CIDA does not report the results expected from the grants, payments and guarantees Canada provides to the regional development banks. For instance, no linkage is made between the resources requested and the results the regional development banks achieve in promoting social and economic development as set out in the IFI Act.

11.111 CIDA should try to link the results expected from its participation in the regional development banks with the money spent. If CIDA finds that this link cannot be made, it should disclose the basis for this finding to Parliament in its Part IIIs.

CIDA's response: *As noted in the response to recommendation 11.49, CIDA agrees to the periodic assessment and reporting of how Canada's objectives as set out in the IFI Act are being achieved through the regional development banks. Indeed, the Agency attempts to make such assessments on an ongoing basis and in particular in the context of decisions on fund replenishment or capital increase negotiations. The Agency will try to improve the link between funds disbursed by Canada to the banks and the results expected from our memberships. The Agency would note, however, that assessing the benefits of participation against Canada's objectives in unequivocal and quantifiable terms is difficult. The regional development banks engage in a range of activities that provide benefits for Canada and the international community that are not readily subject to precise measurement.*

Better information on the risks and benefits associated with Canada's participation in the regional development banks would enhance parliamentary scrutiny.

Improving CIDA's input to the Public Accounts of Canada

11.112 The Financial Administration Act, which prescribes the Public Accounts of Canada, demands a statement of assets and liabilities that shows Canada's financial position at the end of a fiscal year, together with a statement of revenue and expenditure for the fiscal year. As previously stated, we have two concerns about the way Canada's contribution to the regional development banks is treated in the Public Accounts: first, the $391 million paid–in capital is recorded as an asset whereas, in our view, the carrying value of this asset needs to be reconsidered; second, notes payable of $1.1 billion are not presented as liabilities. In our view, the accounting treatment for the legal obligation to make future cash payments to the Funds needs to be reconsidered. We have noted in paragraphs 11.103 and 11.104 our concern about lack of adequate involvement of CIDA's Finance and Corporate Information Branch. We have made related recommendations in paragraphs 11.93 and 11.102.

Improving the IFI Act

11.113 Competition for development assistance funds is on the rise with recent demands from eastern Europe and the countries of the former Soviet Union. At the same time, it is increasingly clear that development problems are more intractable than they once were believed to be. Policy lending linked with structural adjustment programs of the World Bank and the IMF may take a long time to achieve anticipated results in some developing countries. It is time, perhaps, for Parliament to consider monitoring Canada's role and performance at the regional development banks more closely.

It is time, perhaps, for Parliament to consider monitoring Canada's role and performance at the regional development banks more closely.

11.114 For example, there is no "sunset clause" in the IFI Act that would require the government to renew its mandate to participate in the regional development banks based on the results of a performance evaluation. Knowing what results have been achieved in the past few years and what is planned for the future could be useful to Parliament when it approves Canada's payments to each of the regional development banks, or when it engages in policy debates on the subject.

11.115 In Chapter 12 of our 1991 Report, "Membership Payments to International Organizations", we suggested that the Department of External Affairs report periodically — but not necessarily every year — on the costs, activities and results associated with Canada's participation in the field of multilateral co-operation. We think CIDA should do the same for Canada's participation in the regional development banks, perhaps submitting a thorough report when negotiations are under way to either replenish a "fund component" or increase a capital subscription to a "bank component". To draw Parliament into the process in a meaningful way, Parliament may want to consider building into the legislation the requirement for CIDA to submit a periodic report.

11.116 The accountability chain that links these institutions to Parliament also needs attention. For instance, there is no requirement in the IFI Act for the Minister to report periodically on Canada's participation in these banks. Nor is it the practice of the Minister to encourage the Canadian Executive Directors, who reside at the banks and are very knowledgeable about what is happening there, to appear before parliamentary committees to account for the results achieved by these institutions.

11.117 CIDA should seek, possibly through amendments to the International Development (Financial Institutions) Assistance Act, a requirement for conducting a periodic assessment and report to Parliament on the developmental and other returns from Canada's participation in the regional development banks.

CIDA's response: The Agency is currently in conformity with the IFI Act. CIDA currently reports to Parliament through Part III of the Estimates as well as frequent appearances before parliamentary committees, including the recently established sub–committee on the international financial institutions. It is not for CIDA to determine if amendments to existing legislation should be sought.

Chapter 12

Department of Finance

Participation in the Bretton Woods Institutions and in the European Bank for Reconstruction and Development

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Assistant Auditor General: Bonnie Miller
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Department of Finance

Participation in the Bretton Woods Institutions and in the European Bank for Reconstruction and Development

Main Points

12.1 Canada pursues its economic and foreign policy objectives, in part, through its membership in the Bretton Woods and related institutions — the International Monetary Fund (IMF) and the World Bank Group — and the European Bank for Reconstruction and Development (EBRD). Canada's subscription (quota) at the IMF is $4.6 billion. Financial commitments in the World Bank Group and the EBRD are $5.6 billion.

12.2 The roles of the International Monetary Fund and the World Bank Group have evolved over time. Both are now concerned with broader socio–economic goals as well as the traditional objectives of stable balance–of–payments conditions and sustainable economic development, respectively. The international debt crisis, and the creation of the European Bank for Reconstruction and Development to help former communist bloc countries of eastern Europe, may increase the pressure on Canada and other creditor members for more financial support.

12.3 Several factors point to the need for the government to review the objectives, extent and results of Canada's participation in the Bretton Woods institutions, and weigh them against its financial commitments to these institutions and other demands on the public purse. These include the reported decline in the success rate of projects supported by the World Bank, the evolution in the roles and operations of the institutions, and domestic fiscal restraint.

12.4 Canada and some other creditor members have suggested that the World Bank continue to review its rate of loan loss provisioning, in view of the proportion of the loan portfolio that the Bank considered to be high risk and the uncertain global economic outlook.

12.5 The Department of Finance has improved the information it provides to Parliament and the public on Canada's participation. However, it needs to further improve the information on the objectives and results of participation and on the associated financial commitments and risks to which Canada is exposed.

12.6 We are concerned that, because of the vote wording in the Appropriation Act, Parliament is not made fully aware that it is approving a significant financial commitment of callable capital subscriptions when it approves payments to the World Bank.

Introduction

Participation — A Means to Further our Economic and Foreign Policy Interests

12.7 The Great Depression of the thirties and the Second World War inflicted massive economic dislocation on many countries. Reconstructing these economies and establishing mechanisms for international trade and flow of capital were high priorities in many multilateral accords drawn up toward the end of the war and shortly after. Under the umbrella of the Economic and Social Council of the United Nations, two international financial institutions were established at the Bretton Woods Conference of 1944: The International Monetary Fund and the International Bank for Reconstruction and Development (or World Bank).

12.8 Throughout Canada's history, the economic well–being of its citizens has been closely linked to foreign trade and international flow of capital. Thus, Canada has a vested interest in promoting an efficient international monetary system, stable exchange rates, an open trading environment and global development. These goals are the *raisons d'être* of the Bretton Woods institutions. Accordingly, Canada's participation in these institutions is used to pursue, in part, our economic and foreign policy interests.

12.9 The International Monetary Fund. The International Monetary Fund (IMF) was designed to promote the smooth functioning of the international monetary system to facilitate international trade and movement of capital. It provides financial assistance to member countries to help them overcome short–term difficulties with balance of payments. It monitors and analyzes the exchange rate policies and economic performance of all its member countries and discusses its assessments with them.

12.10 The IMF obtains its funds from quotas — subscriptions — paid by all members, partly in their own currency and partly in "hard" currencies. A member country's quota reflects its relative economic importance. Quotas determine each member's relative voting power and determine the maximum amount of balance–of–payments assistance it can obtain from the Fund.

12.11 World Bank Group. Initially established to help with the reconstruction of the war–torn economies of Europe and Japan, the World Bank with its headquarters in Washington D.C. is now the world's largest and most important source of development financing. It and its subsequently established affiliate institutions — the International Development Association, International Finance Corporation and Multilateral Investment Guarantee Agency — make up the World Bank Group. The common objective of the institutions in the World Bank Group is to help raise the standard of living in the developing

Canada participates in the International Monetary Fund, the World Bank Group institutions, and the European Bank for Reconstruction and Development to promote our economic and foreign policy interests.

World Bank Headquarters in Washington, D.C. The World Bank is the world's largest source of development financing (see paragraph 12.11).

countries by channelling long–term financial resources to them.

12.12 Subscriptions to the World Bank by member countries are made up of paid–in capital — a small portion (about 7 percent) of the total — and callable capital (a promise to pay, if necessary). Using these subscriptions and the income from its operations, the World Bank borrows in capital markets to make development loans to developing members, who thereby benefit from easier access to capital and favourable interest rates that are well below what they could obtain on their own.

New Economic Challenges Prompt New Strategies

12.13 After the Second World War, the International Monetary Fund administered a code of conduct to promote stable exchange rates based on a fixed exchange rate linked to the U.S dollar and to gold. Membership at the time was largely limited to industrialized countries. However, between 1971 and 1973, most countries adopted floating exchange rates, requiring the Fund to operate in a very different way.

12.14 In the early 1980s, weak commodity prices, recession in industrial countries, high real interest rates, domestic policy failures and other factors made it difficult for many poorer nations to pay their international debts, either to commercial banks or to other countries. Creditor nations and financial institutions were forced to find ways to cope with a crisis that threatened to collapse the international financial system.

12.15 In response, the G–7 (the seven leading industrialized nations, including Canada) initiated several plans for corrective action that the IMF, with its experience in economic restructuring and its capacity to analyze economic conditions, was particularly well placed to help implement.

12.16 Traditional short–term approaches to balance–of–payments difficulties have not been able to reduce the persistent and repetitive problems plaguing a number of countries over the past two decades. The IMF and other experts believe that long–term structural solutions must be found. Consequently, the IMF has adapted some of its facilities and lending policies to meet the specific needs of certain members. And, although the IMF was not designed as a Third World development institution, it has established the Structural Adjustment Facility and Enhanced Structural Adjustment Facility to lend money to debt–distressed, low–income countries at concessional interest rates and for longer terms. However, the role of the IMF still remains that of a monetary organization primarily concerned with macro–economic issues.

12.17 The World Bank Group's approach to development has also evolved. Traditional development financing focussed on projects and programs with very specific and limited objectives. The wider ramifications — economic, social and environmental — were not fully specified in the objectives and, consequently, were not addressed.

12.18 Since the early 1980s, more and more of the World Bank Group loans have become linked to structural and sector adjustment assistance designed to enhance broad sectors of the economy. In 1992, adjustment lending represented 27 percent of total loans approved. Conditions such as protection of the environment are now attached to certain loans, and concerns are being expressed by the World Bank about the policies of recipient countries. As well, development funding is now expected to dovetail with macro–economic objectives and initiatives, thus moving the operations of the World Bank closer to those of the IMF.

12.19 As the basic strategies of these institutions have evolved in the area of macro–economic reform, their co–operation and co–ordination have improved. However, analyzing the effectiveness of longer–term, multi–objective strategies is intrinsically difficult. The challenge is to clearly specify objectives, develop adequate information and undertake analysis to assist in the efficient and effective allocation and use of scarce development funds.

12.20 The European Bank for Reconstruction and Development. The European Bank for Reconstruction and Development was created in 1991 to funnel financial support to the formerly communist states of eastern Europe, including countries of the former Soviet Union. Its mandate is to foster the transition toward democracy and open market economies, and to promote private and entrepreneurial initiative in those countries. This Bank is also concerned with promoting democratic institutions and human rights.

12.21 The European Bank for Reconstruction and Development's funding is similar to that of the World Bank, but paid–in capital represents 30 percent of the total membership dues compared with 7 percent at the World Bank. It also borrows in capital markets to fund its loans and investments.

Canada's Participation

12.22 Canada's participation in the International Monetary Fund and the World Bank was authorized under the Bretton Woods Agreements Act of 1945. Since the addition of the World Bank affiliates, participation has been authorized under the 1985 Bretton Woods and Related Agreements Act, as amended. Our participation in the EBRD is authorized under the European Bank for Reconstruction and Development Agreement Act of 1991.

12.23 The Department of Finance is the lead manager of Canada's participation in these institutions. Other departments and agencies that play a role are the Canadian International Development Agency (CIDA), External Affairs and the Bank of Canada. Obviously, appropriate co–ordination is crucial.

12.24 The International Finance and Development Division of the Department of Finance manages Canada's relations with the IMF, the World Bank Group and the European Bank for Reconstruction and Development, working through an Executive Director in each institution. The Division:

- reviews the financial policies and operational directives or guidelines of the institutions;
- analyzes and provides input for policy papers, loan documents and proposals for structural adjustment projects of the institutions;
- disseminates information and consults with other departments and agencies concerned; and
- co–ordinates its activities with those of other centres involved in managing other multilateral development banks and Canada's overall Official Development Assistance program.

The Minister of Finance annually reports to Parliament on these activities.

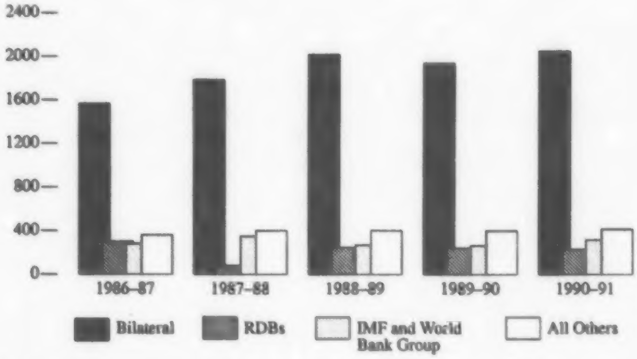
12.25 Canada's Executive Directors in these financial institutions represent other countries, mostly borrowing members, as well as Canada. Thus, they virtually "wear two hats", promoting the interests of Canada as a creditor and those of others they represent as borrowers, even though these interests may occasionally conflict.

12.26 Canada's voting share is marginal (3.2 percent for the IMF at 30 April 1991, 3.0 percent for the World Bank at 30 June 1991 and 3.5 percent for EBRD at 31 December 1991). Canada commands no veto in the affairs of the institutions. Its Executive Directors seek to influence the institutions to adopt policies and administrative arrangements that Canada believes are conducive to sustainable development and consistent with other goals and priorities Canada supports. However, Canada's capacity to influence these institutions' decisions extends significantly further. With a Canadian on each Board of Directors and as a member of the G–7, which collectively exerts great influence over the priorities, strategies and even operations of each institution, Canada can exert influence beyond its limited voting power when it obtains the support of its G–7 allies.

12.27 Canada's participation in these institutions is linked to its Official Development Assistance program. Canada's contribution to the IMF and the World Bank Group in 1990–91 was $320 million, or about 11 percent of its total Official Development Assistance in that year. Per capita, Canada's subscriptions to the World Bank are the highest of the G–7 countries (see Exhibits 12.1 and 12.2).

Exhibit 12.1

Canada's Official Development Assistance Expenditures by Means of Delivery ($ millions)



RDB – Regional Development Bank
IMF – International Monetary Fund

Source: CIDA Annual Reports

Canada's participation in the Bretton Woods Institutions is linked to its official development assistance program.

Cost and Benefit to Canada

12.28 As a member, Canada assists these institutions through paid–in capital subscriptions, callable capital subscriptions (a promise to pay, if necessary), loans and other commitments. It is also committed to abide by the terms and conditions contained in the institutions' Articles of Agreement. At 31 March 1991, Canada's subscription (quota) to the IMF was $4.6 billion. Canada's total financial commitments to the World Bank Group and the European Bank for Reconstruction and Development were $5.6 billion (see Exhibits 12.3 and 12.4).

12.29 Participation gives Canada measurable commercial benefits, namely procurement of goods and services in Canada by the World Bank and International Development Association. Smooth functioning of the world monetary system, enhanced flow of trade and capital, and the conditions for sustainable international economic development promoted by these institutions also benefit Canada, although such benefits are difficult to assess. Membership also gives the government access to information not obtainable through its bilateral programs. Having a voice in the G–7 and on Boards of Directors, however, also imposes a responsibility to share global management risks and burdens.

Audit Objectives and Scope

12.30 The objectives of our audit were, first, to determine how the Department of Finance monitors and reports on the extent to which Canada's participation is effective in achieving its objectives; second, to review how Finance manages the financial risks associated with Canada's financial commitments to these institutions; third, to review how Finance handles the flow of information and how it co–ordinates its activities with other departments and agencies involved; and finally, to determine whether there is adequate disclosure and accountability to Parliament for Canada's participation in these institutions. Our reasons for looking at these areas and what we expected to find are outlined in the various sections of the chapter.

12.31 Our audit focussed on Finance's management of Canada's participation in the Bretton Woods institutions (IMF and the World Bank Group) and included a brief examination of the role of the relatively new European Bank for Reconstruction and Development. Because our audit emphasized the role of these institutions in facilitating sustainable economic growth of developing countries, we devoted the bulk of our attention to Canada's participation in the World Bank Group.

12.32 Although our audit required that we understand the lending operations of these institutions, it was **not** an audit of the institutions.

Observations and Recommendations

Review of Canada's Participation — Objectives and Results

12.33 We examined how Finance monitors and reviews information on the effectiveness of the institutions, particularly in achieving Canada's international development objectives.

12.34 Because of the significant financial commitments involved, it is reasonable to expect:

- a clear statement of the objectives and costs of Canada's participation so that Parliament and the public are aware of the reasons for participating, and are in a position to objectively assess results; and
- periodic review and assessment of the objectives, extent, costs and results of Canada's participation in these institutions by the Department of Finance and the government.

Why Canada participates in the Bretton Woods and related institutions needs to be clearly and completely stated

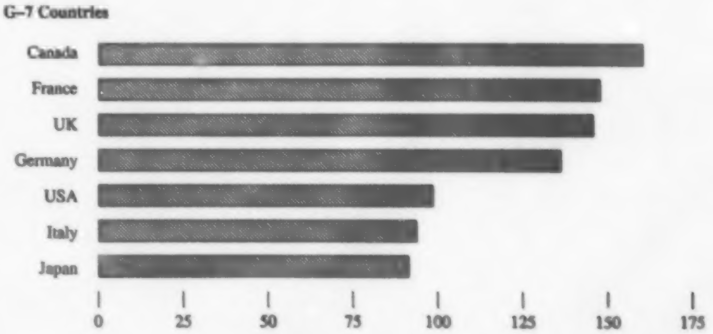
12.35 The objectives of Canada's participation in these institutions must be clearly stated before the cost–effectiveness of participation can be evaluated.

12.36 In its 1991 *Report on Operations Under the Bretton Woods and Related Agreements Act*, Finance states: "Membership in IMF gives Canada a vehicle for promoting a stable world financial system, and orderly and early policy adjustment by countries experiencing unsustainable external imbalances. These are goals which Canada has always supported and which continue to influence Canadian policies toward the Fund." Also, "there are several benefits from Canadian participation in the World Bank. The World Bank exerts a major influence on the global development

The objectives of Canada's participation in the Bretton Woods and related institutions need to be clearly and completely stated, to make Parliament and the public fully aware of why taxpayers' dollars are spent and to provide a basis for assessing results.

Exhibit 12.2

G–7 Members' Subscriptions Per Capita to the World Bank as at 30 June 1991 (U.S. $)



Sources: 1991 World Bank Annual Report and IMF International Financial Statistics

Canada's subscriptions per capita, the highest of the G–7.

agenda, policies, programs, and innovation. It is the world's most important, influential, and largest organization active in the development field. Participation in the World Bank thus gives Canada a voice in relatively large decisions and provides Canada with information not obtainable through bilateral programs."

12.37 Other, different, objectives for Canada's participation in the World Bank Group have been stated in Finance's internal documents: sustainable development, alleviation of poverty, environmental protection and enhancement and "proper" governance through policy–based lending and aid. Canada also expects commercial benefits from its participation: procurement of Canadian goods and services by the World Bank and its affiliates, and employment for Canadians in these institutions.

12.38 These latter objectives and expected results set out in internal documents are not publicly reported in Finance's Part III of the Estimates, or in the annual report on Bretton Woods and other Related Agreements Act. Instead, the objective for international financial organizations is stated in Finance's Part III as: "to provide funds for the payment of Canada's subscriptions to various international organizations". There is no reference to the results expected from those payments. Nor is the related burden–sharing responsibility specified. The objectives of Canada's participation in the Bretton Woods and related institutions are not clearly and completely stated in any one public document to make Parliament and the public fully aware of why taxpayers' dollars are spent — that is, all the reasons for participation and the concomitant responsibilities — and to provide a basis for assessing results.

12.39 Both the public and the internal documents express the goals and objectives of Canada's participation in broad, abstract terms that are not measurable. For example, sustainable development and proper governance are not defined; nor are criteria provided to help assess the extent to which they are achieved. Finance has indicated the need for such criteria, by which, for example, the effectiveness of the International Development Association's performance in reducing poverty can be judged. Generally, targets and indicators of expected results that are of particular interest to Canada are not stated. Independent assessment of their achievement is therefore more difficult. To help in assessing the benefits of participation, the objectives need to be clearly stated

Exhibit 12.3

Canada's Financial Position in the IMF
as at 31 March 1991
(millions)

Subscription (Quota)	$ 4,565	
Less: Notes payable	3,854	
IMF cash on deposit at the Bank of Canada	12	
	3,866	(1)
Reserve position in the Fund	699	(2)
Special Drawing Right (SDR) holdings	1,678	(3)
Less: SDR Allocations	1,210	(3)
Net SDR holdings	468	
Enhanced Structural Adjustment Facility and Guyana loan	59	
Lines of Credit	1,385	(4)
Other Commitments	667	

(1) This amount represents the IMF holdings of Canadian dollars. Approximately one quarter of one percent of Canada's subscription (quota) is cash held on deposit at the Bank of Canada. The remainder of Canadian dollars is held by the IMF in demand notes. Encashment of notes to finance the Fund's operations and transactions results in offsetting changes in the levels of two components of Canada's international reserves, foreign exchange holdings and its reserve position in the Fund.

(2) Canada is entitled to draw this amount on demand from the IMF for balance–of–payments purposes.

(3) The SDR is an international currency created by the IMF, and allocated to countries participating in its Special Drawing Rights Department of the IMF. As an asset, SDR holdings represent rights to purchase currencies of other countries participating in its Special Drawing Rights Department, as well as to make payments to the IMF itself. SDR allocations are liabilities of Canada, as circumstances could arise whereby Canada could be called upon to pay these allocations, in part or in total.

(4) This amount represents Canada's share of a credit arrangement to supplement the IMF's resources. The IMF did not utilize this arrangement in 1991. The line of credit is constrained by Canada's right to opt out of calls on balance of payments and reserve grounds. Any drawdowns would involve an exchange of SDRs or currencies from official reserves in return for a reserve claim on the IMF.

Source: Public Accounts, Department of Finance and Bank of Canada.

and results indicators identified, where practicable, and monitored.

12.40 Where indicators for monitoring the achievement of certain objectives have been specified, they are measured and reported. In the *Report on Operations Under the Bretton Woods and Related Agreements Act*, required by legislation, Finance has provided information on procurement (identifiable expenditures) in Canada by the World Bank and the International Development Association in four categories: consultant services, civil works, machinery and equipment, and all other goods. It has also given the number and percentage of Canadians working in the World Bank. No employment information was provided for the International Monetary Fund. Certain aspects of commercial benefits to Canada are also monitored and reported by Finance and External Affairs. As well, for the International Development Association replenishment negotiations, Finance reviewed and used specific indicators developed by the United Nations Development Program (incidence of poverty or proportion of population below poverty line, life expectancy, education attainment index, adjusted GDP per capita, human development index — by country and region) to develop Canada's position on the regional allocation of IDA resources.

12.41 These indicators provide concrete readings that can help assess the achievement of objectives that have been clearly specified. Reporting them would help make some of the results of participation more apparent. However, alone they are not enough. Changes in the indicators cannot be attributed solely to the activities of the World Bank Group or to Canada's participation. Therefore, periodic review or evaluation that takes into account analyses of these and other indicators and relevant information would provide a more comprehensive assessment of the extent to which Canada's participation in the World Bank Group is achieving the expected results.

12.42 The government should provide a clear and comprehensive statement of the objectives of Canada's participation in the Bretton Woods and related institutions. The Department of Finance should identify, monitor, analyze and report selected indicators that can serve in assessing how well Canada's objectives for participation in these institutions are being achieved.

9

Department's response: *We agree that the objectives of Canada's participation in these institutions need to be clearly stated. The annual reports to Parliament provide a comprehensive overview of the activities of the institutions and the objectives and benefits of Canada's participation. Additionally, extensive reporting to Parliament occurs more directly through frequent appearances before parliamentary committees, including the recently*

Exhibit 12.4

Canada's Commitments in the World Bank Group and EBRD as at 31 March 1991 (millions)

	World Bank Group (1)	EBRD	Total
Net subscriptions (2)	$ 387 (3)	$ –	$ 387
Callable capital subscriptions (4)	4,713	321	5,034
Other Commitments	–	138	138
Total	$ 5,100	$ 459	$ 5,559

(1) World Bank Group consists of the International Bank for Reconstruction and Development, International Development Association, International Finance Corporation and the Multilateral Investment Guarantee Agency.

(2) Subscriptions of $391 million less notes payable of $4 million.

(3) This amount does not include subscriptions to the International Development Association which are expensed when notes are encashed. At 31 March 1991, subscriptions to the International Development Association were $3,531 million. Of this amount, $885 million has not yet been encashed by the International Development Association. At the same date, commitments to the International Development Association, for additional subscriptions were $592 million.

In addition, if Canada subscribes to further shares allocated to it under the 1988 IBRD General Capital Increase, the IBRD paid–in capital subscriptions and callable capital subscriptions will rise by a further $45 million and $1,457 million respectively.

(4) Capital subscriptions are subject to call only when required to meet the obligations of the IBRD created by borrowing or guaranteeing, and to meet the obligations of the MIGA and the EBRD.

Source: Public Accounts and Department of Finance.

established House of Commons sub–committee on the international financial institutions (IFIs). We should note that assessing the benefits of participation against Canada's objectives in unequivocal and quantifiable terms is difficult. The IFIs differ considerably from commercial banks; they engage in a range of activities that provide benefits for Canada and the international community that are not readily subject to precise measurement. To make judgments about the value Canada receives from its participation on narrow commercial criteria would be to ignore these important benefits.

Lessons learned from periodic reviews of how Canada's participation in the IMF and the World Bank Group achieves the objectives that Canada supports would help in deciding how best to allocate limited Official Development Assistance dollars, and could suggest ways of making Canada's involvement more effective.

It is time to review the objectives, extent and results of Canada's participation in the Bretton Woods and related institutions

12.43 Several factors point to the need to review the objectives, extent and results of Canada's participation in the IMF, the World Bank Group and the European Bank for Reconstruction and Development.

12.44 First, as we have noted, the roles, operations and facilities of the institutions have evolved over time. (See paragraphs 12.13 to 12.19.) A full review of the mandates of the institutions against their operations (preferably in collaboration with other interested G–7 members, for purposes of economy and efficiency) could greatly enhance accountability.

12.45 Second, as part of its ongoing evaluation designed to identify areas for improvement, the World Bank has expressed concerns that the success rate of projects it supports has declined. The proportions of projects with problems and of projects reported as unsuccessful by the Operations Evaluation Department of the World Bank have been increasing since 1979. Also, the negative social, cultural and ecological impacts of some projects have become a concern. At the same time, a North–South Institute study has concluded that "multilateral aid has been a splendid deal for Canada in its service of multiple Canadian and global interests". However, the study and subsequent reviews by the Institute have identified multilateral aid issues that need to be addressed. It is difficult to gain a balanced perspective without regular reports on results, or an independent evaluation or public review of the extent to which Canada's objectives are being achieved through the World Bank Group's operations.

12.46 Third, there is international pressure to commit more resources to these institutions. Problems of development, balance of payments and debt in Third World countries persist. Substantial resources are needed to address these problems and to assist in the reconstruction of eastern European economies. All this has generated a demand for additional funding that shows no signs of diminishing. This means increased pressure on Canada and other creditor members for more financial support. Meanwhile, at home, there are budgetary pressures to reduce development assistance along with other expenditures. Faced with domestic fiscal restraint, the federal government needs to assess the results desired and attained through participation in these and other multilateral institutions, and weigh them against the financial commitments to these institutions and against other demands on the public purse.

12.47 Fourth, evaluations would provide useful information to help the government decide how best to allocate the limited dollars available for Official Development Assistance, between multilateral and bilateral aid and between global development banks and regional development banks. One would expect these resources to be allocated, at least in part, to where they are most cost–effective in achieving Canada's objectives. In developing Canada's negotiating position for the tenth increase (replenishment) in subscriptions of the International Development Association, Finance has called for more systematic information on the extent to which the relative efforts by recipient countries to alleviate poverty affect the allocation of Association resources. It has also suggested that the extent to which those efforts are taken into account in allocating Association money needs to be more transparent. Similar principles could apply to the allocation of Canada's Official Development Assistance dollars.

12.48 Fifth, lessons learned from periodic reviews could suggest ways of making Canada's involvement more effective. Reviews could also provide answers to pertinent questions like those in Exhibit 12.5, and others raised by Finance in preparing for the replenishment negotiations mentioned in the previous paragraph.

12.49 Sixth, we are not aware of any comprehensive review of Canada's participation that has been carried out by the federal government since the country joined the institutions in 1945. Finance has carried out substantive but only partial reviews from time to time, usually when member countries have been asked to approve a replenishment of capital or a quota increase. Canada also participated in a 1985 Group of 10 study on the functioning of the international monetary system. As well, the Department reviews and comments on issues of concern to Canada to promote the pursuit of Canada's objectives by the institutions. However, these reviews have not provided sufficient information to Parliament and the public on how well Canada's objectives are being achieved.

Information about the results and benefits of participation needs to be maintained and reported

12.50 The Operations Evaluation Department (OED) of the World Bank produces an annual review of evaluation results by sector and by country. These reports provide a basis for assessing the success of multilateral development efforts in various countries and for identifying strengths and weaknesses of completed projects.

12.51 Finance reviews the World Bank's reports and has based some of its argumentation about the Bank's operational policies on OED results. It has also made recommendations aimed at improving the dissemination of OED results to various departments of the Bank. Finance has noted that, when it comes to specific objectives (poverty reduction, women in development, environment), the Bank tends to focus on quantity (volume of loans) rather than quality (results), and has suggested that a more thorough analysis describing the actual results of the Bank's programs would be more useful. We agree with the Department and encourage it to pursue this and work with other World Bank members to formulate better indicators of results. Meanwhile, the Department could use the reports of the World Bank to distil and provide information to Parliament on how well Canada's objectives and priorities regarding social and economic development of poorer countries are being achieved.

Exhibit 12.5

Possible Evaluation Questions

- What are the objectives and expected benefits of Canada's participation? What priority or value is attached to each?
- Are these objectives still relevant and consistent with the current understanding of MPs?
- Do the objectives accord with the goals and Articles of Agreement of the institutions?
- Are the activities and strategies of the institutions consistent with Canada's Official Development Assistance and other foreign policy objectives?
- What is their contribution to each of Canada's objectives?
- What is the relative effectiveness of the various channels (bilateral, World Bank Group, Regional Development Banks) of delivering Canada's development assistance?
- Do the evaluations (project, policy, sectoral) done by Operations Evaluation Department of the World Bank provide enough information on the achievement of Canada's development objectives?
- Can resources be allocated to these institutions according to their relative effectiveness in achieving Canada's objectives?
- What lessons have been learned through evaluations of World Bank projects and structural adjustment loans, and to what extent have these lessons been applied to modify and improve Canada's Official Development Assistance program?
- What impact would the increased pressure or demand for more resources to assist Third World countries and to support the reconstruction of countries of eastern Europe have on Canada's contributions to these institutions and hence on its future financial requirements?

12.52 We recognize that it is a complex process to evaluate the cost–effectiveness of development assistance delivered to developing countries through multilateral aid. Other countries with development objectives similar to Canada's (Australia, the U.S.A., the U.K., and the Nordic countries) have shown interest in evaluating the results of their participation in multilateral institutions. A joint study or evaluation by Canada and other interested members — especially the G–7 members — would carry more weight and be more economical and efficient for all concerned.

12.53 There is no single best approach to assessing the benefits of participation. Occasional evaluation, such as Australia completed this year, might be appropriate in some instances. Assessment of how reliable the audit and evaluation processes in these institutions are at providing adequate accountability and value–for–money information is another possible approach. Ongoing monitoring of selected indicators of results is yet another way to evaluate performance. Another approach could be through occasional parliamentary reviews. While our audit was in progress, a sub–committee of the House of Commons Standing Committee on Finance was established to study the management and policies of the IMF, the World Bank Group and the European Bank for Reconstruction and Development. This can be an effective review mechanism since this type of parliamentary review encourages public debate.

12.54 Because of the importance of periodically evaluating Canada's participation in these institutions, a legislative requirement to do so — say, no less than every ten years — could be considered. This would provide an impetus to assess the value of Canada's membership, and foster a results–oriented attitude toward participation. It would also help focus attention on the relevance of these institutions to Canada.

12.55 The Department of Finance should investigate the feasibility of Canada undertaking a joint evaluation with other interested members to assess the cost–effectiveness of participation in the Bretton Woods and related institutions as a way of promoting national objectives. Lessons learned could be applied to improve the functioning of the institutions, particularly where it concerns the objectives of countries that supply hard currencies and the financial backing for market borrowing.

12.56 Finance should also consider combining its evaluation capacity with that of other departments and agencies involved (such as CIDA) to assess the extent of Canada's overall participation in multilateral financial institutions.

Department's response: While we agree all efforts should be made to review the results and benefits of participation, we would stress that the Department already evaluates in a comprehensive manner the effectiveness of the institutions at critical stages in the evolution of their activities to ensure the promotion of national objectives. In conducting this evaluation, Canada works closely with other countries, not only at the Executive Board, but in smaller groups of interested member countries. Substantive assessments of the extent of Canada's overall participation in the international financial institutions are conducted with other interested departments and agencies at the time of replenishment and capital increases. Moreover, the Department conducts day–to–day analysis of the policies and operations of the institutions, and seeks to influence such policies and operations in a direction that meets Canadian objectives.

Managing the Financial Risk

Demand continues to mount for financial support to the Bretton Woods and related institutions

12.57 We reviewed the systems and practices used by Finance to manage the financial risk associated with Canada's participation in the IMF, the World Bank Group and the European Bank for Reconstruction and Development.

12.58 We expected Canada's financial commitments to these institutions to be identified and monitored, and the fiscal implications for future deficits and financial requirements regularly assessed.

12.59 Demand for substantial increases in capital subscriptions (both paid–in and callable) continues to mount. Under the IMF Ninth General Review, it is proposed that Canada's subscriptions (quota) increase by some 47 percent. Negotiations are currently under way for the tenth increase in the subscriptions for the International Development Association. As well, there is pressure for a significant infusion of capital to help former communist countries of eastern Europe.

12.60 To meet these additional demands, substantial replenishments of resources may be required by these institutions in the future. Canada and other creditor members may have to consider diverting resources from other uses or raise them through taxation or borrowing to make further replenishments. Finance monitors these developments, estimates future resource requirements and assesses the fiscal implications. Thus, for the tenth replenishment of the International Development Association (the concessional lending arm of the World Bank Group) Finance has reviewed requests for replenishments, with input from CIDA and External Affairs, assessed the need for the replenishments in the context of Canada's fiscal plan and will establish the amount to be recommended to the Minister. A similar process is followed for World Bank general capital increases and the IMF quota increases.

Financial risk associated with participation is considered to be low

12.61 According to Finance officials, the risk associated with Canada's financial commitments in the International Monetary Fund and the World Bank Group is low.

12.62 A few countries are deeply in debt to the IMF and are paying neither interest nor principal. The IMF itself has never written off such accounts, but creditor nations with net investments in the Fund receive lower rates of return, and other borrowing nations pay higher interest rates, thereby covering the delinquent accounts. This sharing of the burden, together with other financial management and control practices, minimizes the risk that the value of Canada's subscriptions — its "reserve position" — in the IMF will be eroded. Any nation is entitled to draw on demand its reserve position for balance–of–payments purposes.

12.63 The risk that Canada will have to come up with large additional financial resources for the World Bank Group and the European Bank for Reconstruction and Development lies primarily in the prospect that the callable capital or the promissory part of Canada's subscription ($5.0 billion at 31 March 1991) could be called so that these institutions can meet their obligations to those who have invested in their securities through the international financial markets. In effect, Canada and other creditor members act as guarantors of the securities issued to private investors by the institutions.

12.64 Since the establishment of the World Bank 48 years ago, no calls have been made on the callable capital. This has been attributed in large part to the preferred creditor status the Bank enjoys and to the sound financial policies and performance of the institution.

Countries in arrears have often been supported through bilateral and multilateral programs to enable them to service their debts with the World Bank and other international financial institutions. Under its Article of Agreement, the total amount outstanding in guarantees, participation in loans, and direct loans made by the World Bank may not exceed 100 percent of the sum of subscribed capital, reserves and surplus. At the end of its 1991 fiscal year, the total amount outstanding represented 60 percent of that sum.

The level of loan loss provisioning for the World Bank needs to continue to be reviewed, particularly from the perspective of the shareholder

12.65 To assess the risk associated with Canada's financial commitments in the World Bank, Finance relies on the reports of the Bank's independent accountant (who acts as auditor), monitors its financial viability, and reviews and influences its financial policies through the Executive Director.

12.66 The independent accountants expressed no reservations in their most recent report on the Bank's financial statements for 1990 and 1991. Financial rating agencies have assigned to the World Bank a Triple–A rating — their highest. This high credit rating reflects the support of the hard–currency member countries in the form of callable capital. Finance continually monitors these credit ratings.

12.67 Adequate levels of reserves and loan loss provision are a critical defence against a possible call on the Bank's callable capital to meet its obligations created by borrowing or guarantees. At 30 June 1991, the reserve–to–loan ratio was 11.2 percent and the loan loss provision rate was 2.5 percent.

12.68 The Department also seeks to influence the World Bank's financial policies through Canada's Executive Director who sits on the Bank's Executive Board. In its review of the Bank's 1991 loan loss provision document, Finance could not determine whether 2.5 percent was adequate and called for more details on why this rate was chosen.

12.69 Canada and some other creditor members have suggested that the present rate of loan loss provisioning may not be high enough given the uncertain global economic outlook, the high level of the portfolio risk indicator, and other factors, and have suggested that the rate be reviewed.

12.70 The World Bank's current loan loss provision of 2.5 percent seems low in light of the situation on 30 June 1991, when the Bank's management assessed 37 percent of the loan portfolio as high risk, and 3 percent as non–accruing; five countries represented 45.1 percent of the loan portfolio; and loans to countries whose loans have been rescheduled represented 49.4 percent of the loan portfolio.

12.71 Because the financial risk to which Canada is exposed in the World Bank is closely linked to the level of provisioning, Finance should consider calling for an assessment, in collaboration with its G–7 partners, of the loan loss provision rate and the method used to determine it, to ensure the adequacy of accumulated provision for loan losses from the perspective of shareholders, so that the risk of a call on capital remains low.

Department's response: *We agree that the financial integrity of the World Bank is critical if our investments in the Bank are to remain sound and if the Bank is to continue to be an effective development institution. In this respect, the levels of reserves and loan loss provisioning are of prime importance. The Executive Board approves these levels at the end of every fiscal year. Moreover, they are discussed at the Board at regular intervals during the year, at which time Executive Directors may decide to increase or* *decrease the rate of accumulation of loan loss provisions. Executive Directors from the G–10 countries typically meet during the week preceding Board discussions on levels of reserves and loan loss provisioning to assess the adequacy of such levels.*

Operating Procedures — Information Handling and Co–ordination with Other Entities

12.72 We reviewed Finance's systems and procedures for collecting relevant information on upcoming IMF and World Bank issues, such as policy papers and loan documents, and for giving feedback to Executive Directors.

12.73 We also reviewed the systems and practices used by Finance to co–ordinate activities with the departments and agencies involved in the Official Development Assistance program to ensure consistency in Canada's position on issues.

12.74 It is reasonable to expect Finance, as the lead agency managing Canada's participation in these institutions, to collect all relevant information on IMF and World Bank issues and ensure that the views of all interested parties are expressed to the Executive Directors in time for the Executive Boards' discussions of the issues. It is also reasonable to expect Finance to co–ordinate the work of all departments and agencies involved, in order to promote consistency in the pursuit of Canada's objectives.

12.75 We found that Finance does collect relevant information on World Bank issues, and that it obtains the views of all parties involved and sends Canada's views and positions to the Executive Directors on a timely basis.

12.76 The responsibilities of each department or agency are established and understood by all involved. Recently, officers from Finance, CIDA and External Affairs documented and presented their roles and responsibilities to the House of Commons sub–committee on International Financial Institutions of the Standing Committee on Finance. They explained how the three departments interact with the World Bank and IMF and also with each other. Finance monitors the institutions' activities to see whether they remain well managed and well financed. CIDA's main role is to provide input on development matters, and External Affairs provides input on foreign policy matters. It also seeks to gain benefits for Canadian business from the activities of the institutions.

12.77 The mechanisms used to co–ordinate the activities of Finance, CIDA and External Affairs are largely informal. An interdepartmental committee exists, but Finance advises us that it has no documented terms of reference and that no minutes of meetings are kept. Other ways to co–ordinate activities include forums and meetings, and memos and telephone calls.

12.78 These informal methods place a great deal of reliance on individual, as opposed to corporate, memory and thus cannot ensure a consistent approach and common positions on issues, especially when new officers come on board. Consideration needs to be given to drawing up written memos of understanding covering the roles and responsibilities of the departments and agencies involved. This would also be helpful in avoiding any duplication of work.

Accountability — Information for Parliament

Information for Parliament needs to be improved

12.79 We reviewed the information reported to Parliament in public documents on the nature, costs (including financial risk) and benefits of Canada's participation in the IMF, the World Bank Group and the European Bank for

Information provided to Parliament and the public on Canada's participation in the Bretton Woods and related institutions and the European Bank for Reconstruction and Development has improved. Further improvement is needed.

Reconstruction and Development. Our purpose was to determine whether it was adequate and understandable for purposes of accountability.

12.80 We expected Parliament to receive relevant, complete, accurate and understandable information on the costs, mechanisms and outcomes of Canada's involvement in the Bretton Woods and related institutions and the European Bank for Reconstruction and Development, so that Members of Parliament can review and approve government proposals concerning Canada's participation in these institutions.

12.81 Parliament is made aware of future increases in IMF quotas and World Bank Group capital subscriptions. IMF quota increases require amendment to the legislation and thus parliamentary approval. The legislation authorizes the Minister of Finance to provide financial assistance to the World Bank institutions, not exceeding the amount specified in an appropriation by Parliament. The Department keeps Parliament informed, in the Annual Report on Operations under the Bretton Woods and Related Agreements Act, about the status of future capital subscriptions for these institutions.

12.82 Once an amount is decided, it is included in an appropriation Bill for Parliament's approval. However, we are concerned that the vote wording in the Appropriation Act, with respect to the 1988 World Bank general capital increase, does not clearly disclose that payments to the World Bank are for purchase of shares and represent only the paid–in capital portion, or about 3 percent of the capital subscriptions for those shares. There is no mention of the callable capital portion, which represents about 97 percent of the total subscriptions. As a subscriber to the shares, Canada is committed to the callable portion. Therefore, we are concerned that Parliament is not made fully aware that it is approving a potential financial commitment when it approves the payments to the World Bank. Since 1988, the callable capital portion of shares purchased by Canada has been almost $1.5 billion.

12.83 The vote wording in the Appropriation Act for payments to the World Bank should clearly indicate that the payments are for the purchase of shares, and should also indicate the amount of financial commitment with respect to the callable capital portion.

Department's response: *Although Parliament is made aware that payments to the World Bank represent the paid–in portion of share subscriptions through our annual report and our appearances before various committees of the House of Commons, we will provide more details in the vote wording in the Appropriation Act in the future.*

12.84 The Department of Finance and Canada's Executive Directors of the institutions have improved the amount and quality of information they provide in the Annual Report on Operations under the Bretton Woods and Related Agreements Act, and the Annual Report on Operations under the European Bank for Reconstruction and Development Agreement Act. These reports provide ample information on the purpose, funding, operations and environment of the institutions. As well, the Department's officials (though not Canada's Executive Directors at the institutions) are often called to testify at hearings of parliamentary committees.

12.85 However, all this information is not sufficient. The reports and Finance's Part III of the Estimates do not give measurable objectives, targets and actual results of Canada's participation. Information on the financial commitments from Canada's participation is diffused and sometimes unclear. For example, in the annual report on the Bretton Woods and Related Agreements Act, information on financial commitments is dispersed throughout the report, thereby making it difficult to determine the total. As well, the report does not clearly indicate how much money has been committed and how much money has been spent for International Development Association subscriptions. As a result, it is difficult for Parliament to comprehend the total financial commitment associated with Canada's participation in these institutions.

12.86 In our opinion, although the information Finance provides to Parliament and the public on Canada's involvement in the Bretton Woods and related institutions has improved over the past few years, further improvement is needed. More complete, understandable and usable information on the objectives and results of Canada's participation, and the associated financial risks, is needed to enable Members of Parliament and the public to assess the costs and benefits of Canada's involvement. Reference could also be made in Finance's Part III of the Estimates to the annual report and other sources of information on participation.

12.87 As Finance continues to improve the information it provides to Parliament on Canada's participation in the IMF, the World Bank Group and the European Bank for Reconstruction and Development, it should also provide more complete and understandable information on the objectives and results of participation and on the resulting financial commitments.

Department's response: *Canada's financial participation in the IMF, World Bank Group and the EBRD is already provided to Parliament in our annual reports, along with Canada's objectives in these institutions. We will, however, review the content and format of these documents to ensure that they are as useful as possible to parliamentarians.*

Accounting treatment for notes payable to the International Development Association needs to be reviewed

12.88 Notes payable to the International Development Association (IDA) — $885 million at 31 March 1991 — are shown on the government's statement of assets and liabilities as a reduction in the government's investment in IDA. The net investment in IDA — the investment, reduced by notes payable — is included in budgetary expenditures and the deficit for the current and prior fiscal years. Since 1 April 1986, note encashments ($152 million in 1990–91) are now made under budgetary authority, whereas notes issued to IDA ($276 million in 1990–91) continue to be made under non–budgetary authority.

12.89 In our view, notes issued are legally binding obligations to make future payments. In essence, they are not substantially different from accounts payable and other debts that the government records and reports as liabilities at the end of the fiscal year. Accordingly, we believe that notes payable to IDA should be shown as liabilities on the government's balance sheet rather than being netted against the investment in IDA. As well, subscriptions made to IDA by the issuance of notes should be included in budgetary expenditures. If subscriptions made to IDA were included in budgetary expenditures at the time of note issuance rather than at the time of encashment, the impact on the deficit would be felt at an earlier date.

12.90 The government should reconsider, and revise as appropriate, its accounting for and reporting of notes payable to the International Development Association.

Department's response: *Finance has consulted with the Office of the Comptroller General (OCG) and we are in agreement that the current accounting treatment is appropriate. The most* *obvious reason is that the notes payable are commitments to IDA, not liabilities, and therefore should not be included with the government's liabilities. There is an agreement to make payments over a scheduled future period, which in turn is used to establish project schedules. Consequently, the costs, as well as the benefits, of our contributions to IDA occur when the notes are encashed and not when they are issued. However, in the interests of enhancing clarity in the presentation of IDA in the Public Accounts, we will review the current balance sheet presentation with the OCG.*

Chapter 13

Department of Finance

Loan Guarantees

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Department of Finance

Loan Guarantees

Assistant Auditor General: Bonnie Miller
Responsible Auditor: Barry Elkin

Main Points

13.1 Loan guarantees are one of the instruments the government uses to promote economic activities it favours. They are extended under loan guarantee programs or on an individual "ad hoc" basis. Outstanding loan guarantees amounted to $5.7 billion in 1990–91. The total authorized amount is about $13.7 billion.

13.2 In 1986, after the significant losses incurred earlier in the decade on loan guarantees, the government introduced guidelines to prevent future losses from affecting the deficit significantly. These guidelines were directed toward sharing the risks with lenders, investors and borrowers.

13.3 Risk sharing provides an incentive for lenders, investors and borrowers to act in ways that, while promoting the achievement of the government's goals, also minimize its financial risk. However, ongoing loan guarantee programs with lender risk–sharing arrangements cover only 26 percent of the total outstanding exposure. Although the guidelines suggest that a substantial portion of the funds should be provided by private sector equity, for ad hoc loan guarantees government assistance ranges from 74 percent to 103 percent of estimated project costs.

13.4 When a loan guarantee is authorized by Parliament through an appropriation vote of $1, it does not indicate a cost against which the government could subsequently be held accountable and this may give the impression that the guarantee is a free good.

13.5 In 1986, the government indicated that it would establish reserves in its financial statements to offset the potential costs associated with new loan guarantees. This has not been done and the potential costs remain unknown until such time as the government has to honour the guarantee.

13.6 The claim rates shown in the Public Accounts do not reflect fairly enough the loss rates of loan guarantee programs. Under the government's formula for estimating these rates, the expected loan losses on five programs we looked at amount to $122 million. A more appropriate formula indicates expected net loan losses of about $511 million for those same five programs.

13.7 Information to Parliament on the costs and risks of loan guarantees needs to be improved and simplified.

Introduction

Nature and Type of Loan Guarantees

13.8 One way government can try to promote desired activities in areas like education, housing, exports, energy supply or regional development is to increase the credit available to finance those activities. Government uses many tools to do this — direct loans, repayable contributions, grants, equity, and the like. Another tool is the loan guarantee.

13.9 In essence, a loan guarantee is a guarantee to a lender — a bank, a credit union or others providing credit or funding to another party — that, if a borrower defaults, the government will repay the amount guaranteed, subject to the terms and conditions of an agreement. Because the guarantee reduces the lender's risk, the borrower should be able to obtain funds at a lower interest rate or negotiate a loan that might not otherwise be obtainable. By providing access to capital on favourable terms, the government in effect provides a subsidy.

13.10 By transferring the risk of default from the lender to the government, the guarantee is intended to reduce credit costs or to channel more credit toward favoured activities. The availability of this additional credit is supposed to give borrowers an incentive for activities that will achieve the government's desired program objectives.

13.11 Loan guarantees do not involve immediate cash spending by the government. For this reason, they can be a more attractive tool to the government than direct loans or grants, particularly in periods of fiscal restraint. However, they can generate sizable financial obligations and significantly affect the government's fiscal framework.

13.12 Loan guarantees are extended under government loan guarantee programs or on an individual "ad hoc" basis. Outstanding loan guarantees amounted to $5.7 billion in 1990–91. The total authorized amount is about $13.7 billion (see Exhibit 13.1).

13.13 Loan guarantee programs establish criteria and procedures to meet a specified policy objective. They usually apply to a large clientele operating in similar circumstances. The legislation for these programs permits a government department to extend guarantees as a matter of course within the parameters specified for the program.

13.14 Ad hoc loan guarantees differ from loan guarantee programs in that there are few borrowers, the value of each loan is large, and the loan guarantees are usually part of a package that includes other government financing such as equity, contributions or direct loans. Ad hoc loan guarantees entail negotiating financial terms case by case.

Loan guarantees do not involve immediate cash spending by the government. However, they can generate sizeable financial obligations.

Exhibit 13.1

Outstanding Loan Guarantees
($ millions)

Loan Guarantee Programs:	1981–82	Outstanding 1985–86	1990–1991	Authorized Amount
Atlantic Enterprise (excludes Westray)	–	–	164	164
Canada Students Loans	837	1,897	3,061	6,862
Small Business Loans	186	475	503	1,011
Air Carriers Insurance Program	86	100	505	914
Indian On-reserve Housing	59	238	598	750
Other	385	352	322	1,756
Sub-total	1,553	3,122	5,153	11,457
Ad hoc Loan Guarantees:				
Hibernia	–	–	–	1,600
NewGrade Energy Inc.	–	–	266	275
Westray	–	–	22	85
Marine Industries Ltd.	–	–	40	55
St. Marys Paper Inc.	–	–	15	15
Ridley Terminal Inc.	–	197	200	230
Other	1,094	27	13	23
Sub-total	1,094	224	556	2,283
Total	2,647	3,346	5,709	13,740

Source: Public Accounts

Outstanding loan guarantees have more than doubled over the last 10 years.

Government Policy on Loan Guarantees

13.15 In 1986, after the significant losses incurred in the early 1980s with Canadair, de Havilland and Massey Ferguson, the government introduced guidelines to prevent future loan losses from putting undue pressure on its fiscal framework. The guidelines were intended to control the design of loan guarantees and to build up reserves to cover future losses (see Exhibit 13.2).

13.16 Three major ad hoc loan guarantees have been extended since 1986, when the new policy was set. All were for the development of energy projects: the Hibernia Project for offshore oil in Newfoundland; NewGrade, a heavy oil upgrader in Regina, Saskatchewan; and the Westray Coal Project in Pictou County, Nova Scotia. At 31 March 1992, the total amount authorized for these new loan guarantees was about $2 billion, and the government's potential liability was $456 million.

Exhibit 13.2

Ad Hoc Loan Guarantees Prompting the 1986 Guidelines to Be Issued ($ million)

Loan Guarantee	Guarantee Limit at Peak	Impact on Accumulated Deficit[1]
Canadair	$ 1,350	$ 1,812
de Havilland	450	586
Massey Ferguson	126	126
Maislin Industries	33	17
St. Anthony Fisheries & Lake Group Ltd.	21	91
Pêcheurs unis de Québec	5	32
Baie verte Mines	1	13
Panartic Exploration	21	21
Bombardier MLW	9	9
Canadian Arctic Co-operation Federation	4	1
Total	$ 2,020	$ 2,708

[1] *The impact on the accumulated deficit exceeded the guaranteed limit in certain instances due to supplementary budgetary financing.*

Source: 1986 Aide-Memoire on loan guarantees – Department of Finance

After having incurred $2.7 billion in loan losses, the government introduced guidelines for loan guarantees.

13.17 Although the government has created only one new loan guarantee program since 1986 — the Atlantic Enterprise Program — outstanding guarantees have more than doubled in the last ten years.

Audit Objectives and Scope

13.18 Our audit objective was to examine and assess the extent of compliance with the government's 1986 guidelines to control the design of new loan guarantees; how the risks and related costs are recognized and accounted for; and the adequacy of the information provided to Parliament about loan guarantees.

13.19 We concentrated on five major loan guarantee programs and on the three major new ad hoc loan guarantees. Although our audit entailed understanding how loan guarantees are administered at the departmental level, we did not audit this aspect. Neither did we audit cost-effectiveness, including economic benefits of projects financed through loan guarantees.

13.20 We also excluded insurance and loan guarantee programs administered by Crown corporations.

13.21 Our work involved the Department of Finance, which is responsible for overseeing the implementation of the 1986 aide-mémoire guidelines on loan guarantees and for managing the fiscal framework; the Office of the Comptroller General, which, along with Finance, is responsible for recommending the form of the Public Accounts; and the departments of Industry, Science and Technology; Energy, Mines and Resources; and Indian Affairs and Northern Development.

Observations and Recommendations

Risk Sharing

13.22 A 1986 aide–mémoire established guidelines for designing new ad hoc loan guarantees and loan guarantee programs and for enriching existing programs. In essence, the guidelines require the government to share risks with participants in the private sector, including the banking community. In exchange for assuming a share of the risks, the government should also share any extraordinary gains (see Exhibit 13.3).

13.23 The way loan guarantees are designed is important because their terms and conditions can induce lenders, investors and borrowers to act in ways that promote the achievement of the government's goals but minimize financial risk. When a lender assumes no risk it has no incentive to lend prudently; just in issuing loans it can produce income. When a beneficiary assumes no risk it too has no incentive to act prudently.

13.24 Our audit revealed that the way current major loan guarantee programs and ad hoc loan guarantees are structured means that other participants assume little of the risk but can enjoy any gains. It also revealed that improvements could be made in the terms and conditions of some ongoing loan guarantee programs regarding the security taken.

13.25 Current terms and conditions for some ongoing loan guarantee programs require guaranteed loans to be secured by the borrower's assets. However, these terms and conditions do not require lenders to take a first charge on the assets used to secure these loans. Lenders have the possibility of obtaining preferred creditor status on other loans they may make to the borrower. As a result, the security against government–guaranteed loans to that borrower may be reduced. In a default situation, the likelihood of government loss is increased. The government intends to fix this loophole in the case of the Small Business Loans Program. As this situation can also arise with other loan guarantee programs, we think it appropriate that the government review their terms and conditions as well.

The government's financial risk associated with major loan guarantee programs is not shared in all cases by lending institutions

13.26 Programs that feature a lender risk–sharing arrangement represent only 26 percent of the outstanding exposure. They include the Small Business Loans Program, the Atlantic Enterprise Program, the Air Carriers Insurance Program, and other small guarantee programs such as the Farm Improvement and Marketing Co–operatives Loans Program. Government's share of risk or loan losses in these programs varies between 85 percent and 95 percent. There is no lender risk sharing in the Canada Student Loans Program and the Housing Program on Indian reserves (see Exhibit 13.4).

13.27 The government's net claims (claims less recoveries) in 1990–91 for defaulted student loans were $78 million. If, for example, financial institutions were required to absorb 15 percent of losses on student loans,

Government guidelines on loan guarantees require the government to share risks with participants in the private sector, including the banking community.

Exhibit 13.3

Assessment Guidelines for Loan Guarantees

1.	Demonstrated need	Reasonable terms and conditions not available without government guarantee
2.	Rate of return	Expected cash flow adequate
3.	Real private sector equity	Substantial portion of funds provided by equity sponsors
4.	Lender risk sharing	At least 15% of the net loss associated with any default
5.	Guarantee fee	Charged to the borrower
6.	Upside benefit	To compensate downside risks
7.	Other terms and conditions	Adequate security and collateral safeguards

the government could save about $12 million a year. To the extent that lender risk sharing would contribute to reducing the rate of student defaults, additional savings could be realized.

In the three ad hoc loan guarantees we examined, the federal and provincial governments together provided significant financial assistance.

13.28 The experience of the Small Business Loans Program also sheds some light on the financial impact of lender risk sharing. In 1985 the government reduced its share of loan losses in the Small Business Loans Program from 100 percent to 85 percent. Net claims paid by the government during the five years ended 31 March 1992 amount to $172 million. This represents 85 percent of lenders' losses on loans, and the government saved about $30 million by sharing the risk with lending institutions.

13.29 The government indicated in the February 1992 Budget, and the Department of the Secretary of State confirmed at a recent hearing of the House of Commons Standing Committee on Public Accounts, that it was negotiating risk–sharing arrangements with financial institutions for the Canada Student Loans Program. We have been advised that the government also intends to negotiate due diligence arrangements with the financial institutions involved in delivering the Housing Program on Indian reserves.

Multiple sources of government support can reduce the private sector's participation in risk sharing

13.30 The objective of sharing risk can be seriously undermined when private sector projects receive government funds through other mechanisms. This is the case with housing projects financed under the Housing Program on Indian reserves.

13.31 Loan and interest repayments are subsidized by the Canada Mortgage and Housing Corporation (CMHC). In effect, CMHC gives Indian bands subsidies that cover a substantial portion of the operating costs of their housing projects. These operating costs include loan principal and interest payments to lending institutions. According to CMHC, 1991 operating subsidies represent 65 percent of total operating costs and as much as 93 percent of loan payments made by Indian bands.

Other participants assume little risk in ad hoc loan guarantees

13.32 Since 1986, major ad hoc loan guarantees have been extended mainly to support government's priority projects — Hibernia, NewGrade and Westray. Special projects like these often involve significant risks because of their size, the length of time they take to develop, their use of new technology (or technology new to a developer) and the financial position of the borrower. The government gets involved in such projects largely because the private sector finds them too risky.

13.33 Our audit revealed that, in the three cases examined, the estimated financial assistance provided by federal and provincial governments was significant. Exhibits 13.5, 13.6 and 13.7 show the risk assumed by federal and provincial governments and the private sector in the Hibernia, NewGrade and Westray projects. While governments provided most of the financial assistance, private sector participants provide valuable expertise.

Exhibit 13.4

**Risk Sharing in
Major Loan Guarantee Programs**

Programs	Authorized Amount ($ million)	Outstanding Loans 31 March, 1991 ($ million)	Net Claims Paid 1986–91 ($ million)[1]	Government Share of Loan Losses %
Canada Student Loans	6,862	3,061	436	100
Indian On–reserve Housing	750	598	1	100
Small Business Loans	1,011	503	165	85
Air Carriers Insurance Program	914	505	21	90
Atlantic Enterprise	164	164	11	85
Farm Improvement Loans	364	135	24	95

[1] *Claims less recoveries*

Major loan guarantee programs with lender risk-sharing arrangements cover only 26% of outstanding guarantees.

13.34 For Hibernia, estimated public sector financial assistance is 74 percent of the net project cost. For NewGrade, the federal government assumed 35 percent of the risk, the government of Saskatchewan 65 percent and CCRL none.

13.35 In both of these cases, lenders did not assume any risk in the pre–production phase. According to the agreements with the lenders, risk sharing would begin only after the project met commercial criteria for production and cash flow — that is, only after completion of the development phase of the project, entailing the highest risk. The NewGrade project has reached the production stage but, since it did not meet the production and cash–flow criteria by the required date, the lenders have refused to accept risk sharing and the government guarantees remain in full force.

13.36 For the Westray guarantee, government financial assistance is estimated at about 103 percent of the net pre–production cost.

13.37 The government introduced loan guarantee guidelines to avoid significant losses of the kind incurred in the early 1980s. The guidelines suggested that a substantial portion of the funds required should be provided by equity owners, and lenders should share at least 15 percent of the net loss associated with any default. However, current major loan guarantee programs and ad hoc loan guarantees allow other participants to assume little risk while enjoying most of the gains. Loan guarantee programs with arrangements for risk sharing among lenders cover only 26 percent of the outstanding exposure. For ad hoc guarantees, estimated government assistance ranges from 74 percent to 103 percent of project costs.

13.38 Inasmuch as authorization is in place for the government to issue several billion dollars in additional loan guarantees, this is troubling. Added to this concern is the fact that the costs associated with loan guarantees are not appropriately recognized and accounted for.

The risks associated with loan guarantees are not appropriately recognized and accounted for

13.39 Given the risk involved and its potential impact on the government

Exhibit 13.5

Hibernia Risk Sharing

The Hibernia project is intended to produce oil from the Hibernia oilfield, located 315 km southeast of Newfoundland on the Grand Banks in 80 metres of water (see details in Chapter 14).

The capital costs are expected to be $5.2 billion before the start of production and a further $3 billion afterward. Operating costs are estimated at $11 billion over the life of the project. The costs, after deducting government grants and contributions, are shared by four joint venturers. The planned sources of assistance in the pre-production phase, shown below, do not attempt to show the flow of cash or the final actual cost.

1990	($ millions)
Estimated pre-production costs ($5,200 million plus interest of $340 million)	$ 5,540
Public sector financial assistance:	
Federal government:	
Contribution	$ 1,040
Loan guarantee	1,660
Other assistance[1]	0
Newfoundland:	
Contribution	11
Canada Newfoundland Offshore Petroleum Board (75% Federal, 25% Newfoundland)	95
	$2,806
Potential tax benefits (calculated by Energy, Mines and Resources (EMR)[2]	1,320
	$ 4,126
Owners' financial assistance	1,414
	$ 5,540

---

[1] Other assistance of $ 300 million is potentially available in the pre-production phase. The current agreement would limit it to the post-production phase. An order-in-council was approved, authorizing the Minister of Energy, Mines and Resources to re-negotiate the agreement. There are no terms and conditions attached to the order-in-council.

[2] Tax benefits are generally available for similar investments. Their effect is important because contributions and loan guarantees have been layered on top of them, reducing the cash investment of shareholders in the project. Writing off certain project costs as they are incurred and the investment tax credit applicable to the project can be used to reduce income tax otherwise payable.

In addition, Newfoundland has provided an exemption from sales tax for capital cost and reduced Hibernia's sales tax rate to 4 percent for operating costs. Neither EMR nor Finance has made an estimate of this benefit.

Loans are secured by project assets only, without recourse to other assets of the owners. The guarantee agreements call for the government to honour the guarantees before realizing on the assets of the project. Lenders have agreed to reduce the guarantee to 75 percent of the loan – and thus assume some of the risk – only after the project meets normal commercial production and cash-flow criteria.

Source: Energy, Mines and Resources files

Public sector financial assistance is estimated at 74 percent of net pre–production costs. Lenders assume no risk for loans made in the pre–production phase.

deficit, we examined how the government accounts for such large risks in its accountability documents. These include the Budget by the Minister of Finance, the Estimates and the Public Accounts.

13.40 The Financial Administration Act requires the government to seek authority from Parliament to extend or increase the limit of a loan guarantee. An appropriation of $1 may be used to extend such authority. This gives the impression that the guarantee is a free good (see Exhibit 13.8).

13.41 The government's accounting policies require it to set up a contingent liability for the guarantees given. These contingent liabilities are disclosed in a note to the Financial Statements of Canada and details are provided in the Public Accounts of Canada.

Exhibit 13.6

NewGrade Risk Sharing

NewGrade (also known as the Regina Co-op Upgrader) is a 50,000-barrel-per-day oil upgrader, integrated with an existing oil refinery. The upgrader and the refinery are separate companies. The refinery is owned and operated by Consumers' Co-operative Refineries Ltd. (CCRL) of Regina. NewGrade was incorporated to construct, own and operate the upgrader, which was built to use Saskatchewan heavy oil feedstocks. NewGrade is equally owned by CCRL and the Province of Saskatchewan. The planned sources of assistance in the pre–production phase shown below do not attempt to show the flow of cash or the final actual cost.

1989	($ millions)
Estimated pre-production costs[1]	$ 795
Public sector financial assistance:	
Saskatchewan government equity	$ 160
Saskatchewan government loan guarantee	360
Federal Loan Guarantee	$ 275
	$ 795
CCRL financial assistance	$ 0
	$ 795

---

[1] *Includes losses funded by the guarantees.*

NewGrade is a stand-alone company. Therefore, tax benefits can be applied only against taxable income and taxes payable in future years. However, these benefits are unlikely to be realized in the foreseeable future.

Saskatchewan also advanced $75.7 million to fund the operating losses of the company, which continue because of NewGrade's heavy debt load. The first payment of principal is due in December 1992.

Loans are secured by project assets only, without recourse to other assets of the owners. The guarantee agreements call for the government to honour the guarantees before realizing on the assets of the project. Lenders agreed to reduce the guaranteed portion of the loan – and thus assume some of the risk – only after the project had met normal commercial production and cash-flow criteria. Since the project did not meet these criteria by the required date, lenders refused to accept risk sharing and the guarantees remain in full force.

Source: Energy, Mines and Resources files

The Province of Saskatchewan assumes the risk for about 65 percent of net pre-production costs, the federal government assumes 35 percent and the CCRL assumes none. Lenders assume no risk for loans made in the pre-production phase.

13.42 The deficit is charged when events indicate that the government will have to incur an expenditure to cover the contingency, and the amount can be reasonably estimated. The required funds will have to be provided by Parliament.

There is no recorded reserve on the balance sheet of Canada

13.43 The treatment of loan guarantees in these accountability documents is unsatisfactory in a number of respects. First, there is no mention of loan guarantee costs in the Budget, against which the government could be held accountable at the reporting stage. Second, the cost or risk of loss of the guarantees is not recognized on an annual basis but only many years later, when it finally becomes evident that the government must provide cash to pay for them.

13.44 The 1986 guidelines on loan guarantees recognize that there is a cost associated with them, and that there is a need to promote more realistic trade–offs between loan guarantees and other financial instruments like repayable contributions or direct loans.

13.45 The government indicated in its 1986 Budget that reserves would be established in its balance sheet to offset the potential costs associated with new loan guarantees. These reserves would be sufficient to ensure that defaults would not exert undue pressure on the fiscal framework. However, no such reserve is recorded on the balance sheet of the Government of Canada (see Exhibit 13.9).

The basis for estimating the risk of loss is inappropriate

13.46 The Statement of Contingent Liabilities included in the Public Accounts discloses claim rates (net claims as a percentage of outstanding guarantees) associated with loan guarantee programs. These rates do not reflect fairly enough the risk of loss in such programs, and therefore can mislead the public about the size of government liability for loan guarantee programs.

13.47 Exhibit 13.10 compares potential liabilities based on claim rates shown in the Public Accounts with potential liabilities based on the percentage of net claims to all loans made since program inception. The differences are notable. Under the government's formula, the estimated financial loss associated with the five programs included in the exhibit is $122 million, which means that if these programs had ended in March 1991 the government's net loan losses would have been about $122 million. The government's estimated liability for the same programs would be about $511 million if it used our formula. We believe there is a need to review the formulas used to estimate the risk of loss associated with loan guarantee programs.

13.48 The Housing Program illustrates another problem. The 0.1 percent claim rate suggests that there is virtually no risk and relatively little cost associated with the guarantees extended under this program. As we said earlier, this is because operating costs that include loan payments are subsidized by CMHC.

13.49 A related issue is the long–term commitment by CMHC to pay these subsidies. Subsidies are provided under operating agreements between Indian bands and CMHC. They are available over the total loan amortization period, provided the bands continue to meet the terms of the operating agreements. Subsidies paid in 1990–91 amounted to $59 million. By 1994–95, CMHC expects annual subsidies to increase to $100 million.

13.50 An estimate of the default cost for ad hoc loan guarantees is not made. An ad hoc loan guarantee is not a free good. Historically, ad hoc loan guarantees have had a much higher rate of default than loan guarantee programs.

13.51 The failure to appropriately recognize the financial costs associated with loan guarantees impinges on the objective allocation of scarce tax dollars. Reliable cost information is also critical to the success of the government's expenditure restraint program.

Exhibit 13.7

Westray Coal Risk Sharing

Westray coal mine in Pictou County, Nova Scotia is owned by Curragh Inc. It began production in August 1991. On 9 May 1992, an explosion at Westray killed 26 miners and destroyed the lower section of the mine. Production had not yet resumed. The planned sources of assistance in the pre–production phase, shown below, do not attempt to show the flow of cash or the final actual cost.

1988	($ millions)
Estimated pre-production costs	
Fees due to a party related to Westray:	
Management fees due including capitalized interest of $1.1 million	$ 7.8
Head Office Fees due	2.1
	$ 9.9
Other construction costs including $7.3 million of subsidizable interest during construction	120.8
	$130.7
Public sector fnancial assistance:	
Federal government:	
Interest rate buy-down	$ 3.7
Loan guarantee[1]	85.0
Nova Scotia government loan	12.0
	$100.7
Potential tax benefits[2]	34.2
	$134.9
Expected financial benefit to owner	4.2
	$130.7

---

[1] Technically the government did not guarantee the bank loan; it insured it to a limit of 85% of the bank's net loss.

[2] Tax benefits are generally available for similar investments. Their effect is important because contributions and loan guarantees have been layered on top of them, which reduces the cash investment of shareholders in the project. Writing off certain project costs as they are incurred, and the investment tax credits applicable to the project, can be used to reduce income tax otherwise payable.

Loan terms required the owner to carry all-risk course-of-construction insurance among other covenants. The loan guarantee requires the lender to call the loan if it would call the same type of loan without a guarantee in similar circumstances. In June 1992, the lender called the loan and filed a plan with Industry, Science and Technology to realize on the assets. Ninety days after calling the loan, the lender is entitled to file claim for 85% of its net loss (to a maximum of $85 million, but estimated at $80.75 million at 10 August 1992), which the government is obliged to honour ninety days after receiving a complete and valid claim. At that point, the lender will have no further obligation to realize on assets. In determining the net loss, the lender may deduct from proceeds of disposition of the assets reasonable costs in realizing on the assets. Any recoveries will be split 85/15 between the government and the lender. Thus the lender's exposure consists of 15 percent of the loan loss.

Source: Industry, Science and Technology files

Public sector financial assistance is estimated at 103% of pre–production costs.

13.52 There is a need for an appropriate accounting and reporting policy for loan guarantee costs. The government should recognize the cost or risk of loss of a loan guarantee on an annual basis and should account for loan guarantee costs by establishing an appropriate reserve in its balance sheet. There is also a need for the government to review how it estimates the costs of loan guarantees.

Government's response: The government acknowledges the need for an appropriate accounting and reporting policy for loan guarantees and other contingent liabilities. We propose to review our existing policies and practices, and how costs are estimated, with a view to establishing a new policy to fairly reflect these costs in the summary financial statements of the Government of Canada.

Exhibit 13.8

Excerpt from Supplementary Estimates (B), 1985–86
Energy, Mines and Resources
Energy Program

	Previous Estimates $	This Supplementary Estimate $	Total $
Vote 5b — Energy — Operating expenditures — Pursuant to Section 22 of the Financial Administration Act to authorize the Minister on behalf of Her Majesty the Queen in Right of Canada to provide a guarantee from time to time in accordance with terms and conditions approved by the Minister of Finance for loans not exceeding in the aggregate $275,000,000 to NewGrade Energy Inc. for a heavy oil upgrader...	136,342,505	1	136,342,506

This is the wording for the $1 vote authorizing the $275 million loan guarantee to NewGrade.

Exhibit 13.9

Excerpt from 26 February 1986 Budget Papers

> "The net impact on the government's accumulated deficit over the past five years, resulting from paying off guaranteed loans and providing supplementary financing, has been an increase of more than $2.7 billion. These payments include $1.8 billion in the case of Canadair, $0.6 billion in the case of de Havilland and $0.1 billion in the case of Massey Ferguson.
>
> Accordingly, a number of guidelines for loan guarantee proposals have been put in place. Consistent with these guidelines, the government will need to be satisfied that there are reasonable prospects that a project is economically vieble, and that the private sector, including the lending community, is willing to share in the risk. The recipients of new guarantees will, as a general rule, be charged a fee in recognition of the value conferred by the guarantees. Where appropriate, the government will strive to ensure that the terms of any loan guarantee agreement allow it to share in any extraordinary gains as a *quid pro quo* for its acceptance of risk.
>
> In addition, reserves will be established within the government's balance sheet to offset the potential costs associated with the new loan guarantees. These reserves, together with tighter management practices put in place, should ensure that defaults do not exert undue pressure on the fiscal framework."

Information to Parliament

Current information on loan guarantees can be improved and simplified

13.53 Disclosure of loan guarantees. Large guarantees are not always disclosed separately in the Public Accounts. The Westray guarantee is one example. Although approved under the Department of Industry, Science and Technology Act, the Westray loan guarantee was recorded under the Atlantic Enterprise Program (AEP) for reporting purposes. Ad hoc guarantees extended under Industry, Science and Technology authority are typically disclosed separately in the Public Accounts. Because it was not disclosed separately, Parliament has not been given the opportunity to affirm the appropriate amount or take notice of the fact that the guarantee has been extended. There is no specified maximum exposure for the Atlantic Enterprise Program or its successor, the Action Program; AEP loan guarantees are issued under Industry, Science and Technology's $1.2 billion authorized limit that applies to its other loan guarantees.

13.54 Limited information. No information on outstanding loan guarantees or net claims paid for the Housing Program on Indian reserves is provided in Part III of the Estimates of the Department of Indian Affairs and Northern Development.

13.55 In addition to disclosing the total amount of loan guarantees issued, the government should disclose separately all loan guarantees exceeding a certain amount. All costs associated with both loan guarantee programs and ad hoc guarantees should be disclosed.

Government's response: *The government proposes to review its disclosure in the Public Accounts of loan guarantees and other contingent liabilities, to ensure an appropriate level of information is provided.*

Exhibit 13.10

Estimated Liability
Major Loan Guarantee Programs

Programs	Outstanding Loans ($ million) 91–03–31	Government Estimates		Our Estimates	
		Claim Rates[1]	Estimated Liability ($ millions)	Claim Rates[2]	Estimated Liability ($ millions)
Canada Student Loans	3,061	2.7%	83	13.8%	422
Housing Indian Reserves	598	0.1%	1	0.9%	5
Small Business Loans	503	5.7%	29	3.7%	19
Air Carriers	505	1.2%	6	8.6%	43
Atlantic Enterprise	186	1.8%	3	11.9%	22
			122		511

[1] *Public Accounts – Net claims paid less fee revenue as a percentage of outstanding guarantees for last five years*

[2] *Net claims paid plus collection costs as a percentage of total loans made since program inception*

Disclosed claim rates tend to underestimate the government liability for loan guarantee programs.

Chapter 14

Department of Energy, Mines and Resources

Energy Megaprojects

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Department of Energy, Mines and Resources

Energy Megaprojects

Assistant Auditor General: David Rattray
Responsible Auditor: Ellen Shillabeer

Main Points

14.1 We examined the energy megaprojects assisted and funded by the Department of Energy, Mines and Resources. Our observations on the Hibernia, Lloydminster Bi–Provincial Upgrader and Regina NewGrade Upgrader projects point to some fundamental weaknesses:

- lack of a comprehensive set of clear and measurable objectives;
- inadequate co–ordination of benefit monitoring;
- deficiencies in the follow–up of environmental assessment recommendations and commitments;
- continuing gaps in effectiveness measurement; and
- limited and poor reporting to Parliament and the public in Part III of the Main Estimates.

These are important concerns because of the magnitude, visibility and potential significance of current and possibly future megaprojects.

14.2 Clearly, means must be found to more effectively manage the federal interest in shared or joint projects that involve different levels of government and the private sector. Appropriate controls, including careful monitoring, are essential if federal interests are to be protected. Elaboration of central agency policies would contribute to better management of, and guidance to, the federal involvement in shared or joint projects.

14.3 The Department of Energy, Mines and Resources needs to better account for results: for what megaprojects have or have not achieved with taxpayers' money. It is not sufficient to control and account for financial expenditures only. It is also necessary to account for results in order to permit parliamentary and public scrutiny of the outcomes of expenditures.

Introduction

Development of Canada's Energy Resources

14.4 The objective of the Energy, Mines and Resources Program is to advance the development of Canada's economy, in a manner consistent with federal environmental and social objectives, by contributing to the timely and efficient development and use of Canada's mineral and energy resources, and by augmenting knowledge and understanding of the Canadian landmass. The Department accomplishes this objective through a wide range of activities. In recent years, financial support of selected large–scale energy projects has been a prominent means of supporting the development of the energy sector.

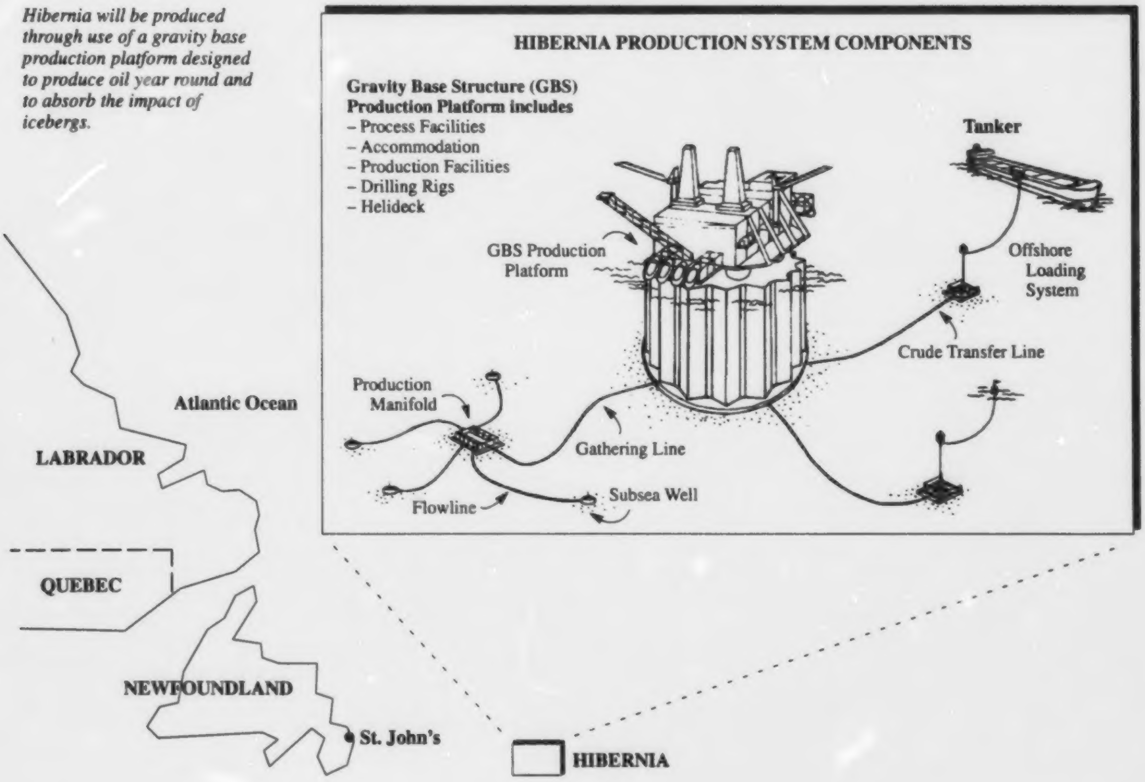
14.5 Financial incentive programs, such as the Petroleum Incentives Program, were the Department's primary vehicle for supporting the oil and gas industry during the 1980s. The government has phased out these general financial incentive programs, and entered into agreements to provide financial support to specific energy projects. The magnitude of these projects has caused them to be referred to as "megaprojects".

14.6 Each energy megaproject is unique, yet the projects all have the following characteristics:

Exhibit 14.1

The Hibernia Project

Hibernia will be produced through use of a gravity base production platform designed to produce oil year round and to absorb the impact of icebergs.


HIBERNIA PRODUCTION SYSTEM COMPONENTS
Gravity Base Structure (GBS)
Production Platform includes
– Process Facilities
– Accommodation
– Production Facilities
– Drilling Rigs
– Helideck
Tanker
GBS Production Platform
Offshore Loading System
Crude Transfer Line
Production Manifold
Gathering Line
Flowline
Subsea Well
Atlantic Ocean
LABRADOR
QUEBEC
NEWFOUNDLAND
St. John's
HIBERNIA

Source: Hibernia Project Update (January 1991)

- high cost and capital–intensive;
- high risk because of price uncertainties as well as technological and environmental factors;
- return on investment realized only over a long term;
- provincial government and/or private sector participation; and
- federal support essential in order to proceed.

14.7 The Department of Energy, Mines and Resources (EMR) supports the following energy–related megaprojects:

- Hibernia: a $5.2 billion project to develop the Hibernia oilfield off Newfoundland, with the first production of oil expected in late 1997.
- Bi–Provincial Upgrader near Lloydminster on the Alberta–Saskatchewan border: a $1.6 billion joint venture to build and operate a heavy oil upgrader, with start–up expected by late 1992.
- NewGrade Upgrader: a $700 million heavy oil upgrader completed in 1988 in Regina, Saskatchewan.
- Vancouver Island Pipeline (VIPL): a $355 million project that completed construction of a natural gas pipeline in October 1991 to consumers on Vancouver Island and the West Coast.
- OSLO (Other Six Leases Operation): a $117 million feasibility study completed in December 1991 for a multi–billion dollar joint venture oil sands project.

Exhibit 14.2

EMR's Participation in Energy Megaprojects ($ Millions)

Project	Activity	Mechanisms for Participation	Estimated Capital Cost (Original)	Federal Commitment	Project Status	EMR Budget (%)	
						91–92	92–93
HIBERNIA	Offshore Oil Production	Contribution and Loan Guarantees	$ 5,200 $ (5,200)	$ 2,700	Under Construction	18.5	31.4
BI–PROVINCIAL UPGRADER	Heavy Oil Upgrader	Equity Ownership	$ 1,632 $ (1,267)	$ 530	Under Construction	15.9	4.9
NEWGRADE UPGRADER	Heavy Oil Upgrader	Loan Guarantee	$ 700 $ (715)	$ 275	Operational	–	–
VANCOUVER ISLAND PIPELINE	Natural Gas Transmission	Contribution and Repayable Contribution	$ 355 $ (279)	$ 150	Completed	1.7	–
OSLO ENGINEERING STUDY	Tarsands Oil Production	Contribution	$ 117 $ (130)	$ 46	Completed	0.7	–
TOTAL			**$ 8,004** **$ (7,591)**	**$ 3,701**		**36.8%**	**36.3%**

Source: Departmental Monitoring Reports, Part III Estimates, Financial Statements

Audit Scope and Objectives

14.8 We chose to examine and report on the Hibernia, Bi–Provincial Upgrader and NewGrade Upgrader projects because of the large federal commitments involved, as well as the risks and significance of these projects. Further details on these three megaprojects are provided in Exhibit 14.6.

14.9 Our audit objective was to assess whether the Department's co–ordination of all the parties involved in the megaprojects is adequate to protect federal interests and to attain federal objectives. More specifically, we examined the clarity of project objectives, as well as the Department's management of project risks, monitoring process, protection of the environment, effectiveness measurement, and reporting to Parliament and the public. Where relevant, we examined whether federal central agency policies were adequate in the circumstances and were complied with, and whether adequate guidance was provided to the Department by the central agencies. We also examined evaluations of prior financial incentive programs funded by the Department, with a view to identifying concerns that might also affect evaluations of the energy megaprojects.

Observations and Recommendations

Objectives of federal involvement are unclear

14.10 Providing assistance to energy megaprojects is consistent with the Department of Energy, Mines and Resources' objective of resource development. However, federal participation in these projects is not solely to develop energy resources. Other reasons for federal involvement in energy megaprojects have been communicated through the Minister's speeches, parliamentary discussions, departmental press releases, and other federal documents.

14.11 The public statements of intended results for energy megaprojects include regional employment, technology transfer, economic diversification, enhancement of Canadian oil supplies and financial returns to Canada (see Exhibit 14.3). The project agreements signed by the federal government focus more on the means of achieving results than on the specific results to be achieved. Both in the project agreements and in public statements related to the projects, many objectives are stated in such general terms that it is difficult to understand their precise meaning.

The purposes of the megaprojects are not clear.

14.12 The agreements were negotiated between federal, provincial, and private sector participants. We recognize that in the process of negotiating common objectives among all participants, some federal objectives may have been diminished or lost. As shown in Exhibit 14.2, a considerable amount of federal taxpayer money is at stake in these projects. There is a need therefore to focus on the purpose of the federal expenditures – the desired results or outcomes.

14.13 The Department has told us that it believes it should be accountable only for the intended benefits stated in the legal agreements. During our audit we noted that departmental publicity surrounding the megaprojects continues to cite other objectives and benefits that are not contained in the legal agreements. Various federal documents we examined, which can be regarded as reasonably authoritative in their own right, also cite other objectives and benefits. This reflects a multiplicity of objectives, which is confusing to the observer. Hence the purposes of the energy megaprojects are not clear.

14.14 A single definitive statement of measurable objectives has not been prepared for any of the megaprojects we examined. The lack of clearly defined objectives makes it difficult to assess results. If progress cannot be measured against clear objectives and specific intended results, then Members of Parliament may be unable to effectively question the Department on how the achievements that are realized compare with those that were intended, as well as with the dollars spent. Also, it may be equally difficult for the Department, or others, to evaluate the achievement of the government's broader purposes in assisting the energy megaprojects.

14.15 Good administration of the government's affairs is predicated on prudence, which is commonly defined as care taken to avoid undesired consequences. It is reasonable to expect a clear statement of objectives at the outset of any project, to be able to determine whether intended results are being achieved and that care has been taken to avoid undesired consequences. Prudence in administration requires that outcomes and results be scrutinized in the context of their costs to determine whether Parliament and taxpayers are receiving what was paid for.

14.16 The Department of Energy, Mines and Resources should develop a comprehensive set of clear measur-

Exhibit 14.3

Statements of Intended Results and Benefits from Megaprojects

	Intended Results per Part III Estimates	Intended Benefits per Agreements	Intended Results per EMR Publications, Press Releases and Ministerial Speeches	Intended Results per Parliamentary Debates
HIBERNIA	Enhanced security of supply Major impact on regional economies	An estimated 55–60 percent of initial $5.2 billion expenditures to be Canadian/Newfoundland content on a best–efforts basis An estimated 2/3 of project employment prior to start of production to be Canadian Encourage consortiums to promote technology transfer Certain fabrication, assembly and outfitting to be done in Newfoundland. Opportunities for the transfer of technology and enhanced project management skills for Canadian engineers.	Regional and national employment opportunities New opportunities for Canadian business Increased revenue for Newfoundland through royalties, corporate income tax, and retail sales tax Enhanced capability for Canadian engineering firms Economic diversification Diversification of energy supply sources Increased technical expertise in the development of offshore energy resources.	Canadianization of Hibernia resources Positive return on Canadian investment Regional and national employment opportunities Security of oil supply Development of new technology and industry
BI–PROVINCIAL UPGRADER	Enhanced energy supply Major impact on regional economies	Employment and industrial benefits 90 percent Canadian content estimated in project goods and services on a best–efforts basis 95 percent Canadian content estimated in direct employment on a best–efforts basis	Secure long–term market for heavy oil production Regional and national employment opportunities Spinoff benefits to secondary industries in Canada Enhanced energy supply	
NEWGRADE UPGRADER		Significant material benefits to Saskatchewan and Canada	Less dependence on imported oil Regional employment opportunities	Increased domestic oil production

able objectives for each energy megaproject in order to provide a sound basis for:

- **reporting the direct results achieved for funds spent; and**
- **evaluating whether the government's purposes have been achieved.**

Department's response: *By their nature, energy megaprojects can have diverse and significant impacts. In consequence, descriptions of the projects have identified a multiplicity of potential impacts. The legal agreements containing the terms and conditions of financial participation by Canada set out the direct results which are expected to be achieved. The direct results expected for each project are clear and will form the basis for reports by the Department on project achievements. The Department does agree that it would be useful to develop a more definitive statement of wider potential impacts which could be used in evaluating the overall results of each energy megaproject.*

Inadequate co-ordination and protection of federal interests

14.17 The federal government is participating in energy megaprojects to accomplish various objectives. We do not comment on the appropriateness of the government's decisions to enter into such ventures, or on its right to do so. We would expect that where the government decides it is important and useful for it to assist in some high-risk ventures that could not be started without government help, it needs to identify the associated risks and take steps to contain them.

14.18 Many energy megaprojects are risky commercial ventures. Success and profitability are uncertain given the risk factors involved, including technological challenges, fluctuating oil and gas prices and environmental issues. Other risks may also be involved, such as the withdrawal of support by a participant, as in the case of Gulf Canada Resources Limited's notice of intent to withdraw from the Hibernia project in February 1992. Construction cost overruns are another potential megaproject risk. In the case of the Bi-Provincial Upgrader, the federal share of cost overruns to date is $129 million.

14.19 The taxpayer has a right to expect that expenditures of public funds will be managed prudently. This is fundamental to the stewardship of government affairs where federal managers are entrusted with the management of taxpayers' money. Consequently, when the federal government participates in such high-risk ventures as the development of the Hibernia oil field and the Bi-Provincial Upgrader, it is necessary for managers to undertake measures to protect federal interests.

14.20 The federal government is only one of several participants in these megaprojects, and it is not the project manager for any of the megaprojects. This makes it very important that the legal agreements signed by the government specify, in the clearest possible terms, the rights, limitations and obligations of the federal government as well as of the other participants.

14.21 We examined the legal agreements for the three megaprojects selected for this audit. Although the federal participation in each project is different, certain risks are similar. We therefore compared the agreements as to the rights and limitations of the federal government associated with some common risks.

14.22 Given the amount of money the federal government has committed to the Bi-Provincial Upgrader project ($530 million to date), the related legal agreements fail to cover some important kinds of risks that are considered in the Hibernia and NewGrade agreements. The Bi-Provincial Upgrader agreements are virtually silent on the following important matters (see Exhibit 14.4):

- limits to the federal government's legal liability;
- financial liability should the facility be destroyed or damaged; and
- federal commitment to funding cost overruns.

14.23 Other federal interests are not as well protected for the Bi–Provincial Upgrader as might be expected, given the magnitude of federal equity participation in this project. Specifically, the federal government is making large direct expenditures for considerations of economic benefits, yet the clauses identifying these benefits use vague terms such as "best efforts" (to achieve targets for Canadian content). In contrast, in the Hibernia project, which also involves direct federal expenditures, some of the economic benefits provisions are much more specific, for example, requiring certain construction and employment in Newfoundland.

14.24 Another contrast is the Department's access to project information. In the case of NewGrade, the Department has a representative on the project's Board of Directors. Although there are three federally appointed representatives on the Bi–Provincial Upgrader Board of Directors, none is employed by the Department. The federal government has chosen a less direct form of involvement with the Bi–Provincial Upgrader than it uses for NewGrade. Yet, in comparison, its equity commitment for the Bi–Provincial Upgrader ($530 million) well exceeds the federal loan guarantee commitment for NewGrade ($275 million).

14.25 It must be noted that agreements for each of the megaprojects were negotiated at different times. The provincial and private sector parties involved also had their own interests to protect. Thus protection of federal interests had to be negotiated in the context of these competing interests. We recognize that this was not an easy task.

14.26 There are several ways of providing federal assistance to other parties, for example grants, contributions, loan guarantees and equity participation. Whatever the form of assistance, certain central agencies of the federal government have a key role to play in establishing reasonable rules and mechanisms for protecting federal interests. Under the Financial Administration Act, Treasury Board has legal responsibility for overseeing the system of financial administration in the government of Canada. Treasury Board Secretariat and the Office of the Comptroller General advise on matters of financial administration. In addition, the Department of Finance advises on matters related to its responsibility to ensure orderly borrowing by the Government of Canada.

Exhibit 14.4

Risks Associated With the Bi–Provincial Upgrader

Limits to Legal Liability

The federal government has entered into an unincorporated joint venture arrangement with the provinces of Alberta and Saskatchewan and with Husky Oil Operations Limited to construct and operate the Bi–Provincial Upgrader near Lloydminster on the Alberta–Saskatchewan border. The federal government, as an owner, is at risk for any legal action brought against the joint venture. As the business arrangement currently stands, federal legal liability is not limited to the value of its share of the joint venture assets. By comparison, the government is not an equity participant in either Hibernia or NewGrade and is therefore less vulnerable to legal liability.

Facility Destroyed or Damaged

The insurance provisions for Hibernia and NewGrade are explicit in asking that insurance coverage be obtained to cover joint property, materials, third–party liabilities, and contractual liabilities. In contrast, the original Bi–Provincial Upgrader Joint Venture Agreement, signed in September 1988, was silent on this matter. The Bi–Provincial Upgrader Construction Management Agreement, signed in April 1990, states that the Construction Manager will use "best efforts" to obtain and maintain the type of insurance that the Joint Venture Board approves. No specific type of insurance is mentioned in the agreement.

Cost Overruns

Federal assistance to both Hibernia and NewGrade is limited by the nature of the federal participation in the projects (non–equity federal participation). Both of these projects have the owners determining in advance how cost overruns would be funded. The federal government would not necessarily be involved in any additional funding.

The Bi–Provincial Upgrader Agreements do not contain any clauses on how cost overruns would be funded by the equity participants, which include the federal government. The Joint Venture Agreement sets a maximum amount for the government to contribute based on the initial estimated cost of the project. The total project cost has now exceeded the estimated cost. The federal government, as an equity participant, has chosen to contribute an additional $129 million to ensure the continuation of the project.

14.27 We discussed the legal agreements and funding arrangements for the three megaprojects with senior officials of Treasury Board Secretariat, Office of the Comptroller General and the Department of Finance. In general, we found that existing central agency policies or minimum requirements do not specifically relate to joint ventures or shared projects that the federal government supports but does not manage or control. Treasury Board Secretariat and the Office of the Comptroller General had little policy basis for advising on the basic requirements to be included in the terms and conditions of the megaproject agreements.

14.28 We did note that the Department of Finance provided useful advice in the negotiation of the megaproject agreements. This is reflected in legal clauses related to financing, cash flow information and other financial matters pertaining to Department of Finance responsibilities. We also noted the beneficial advice given by the Office of the Comptroller General on efficient and cost–effective cash management and banking arrangements for the Hibernia and Bi–Provincial Upgrader projects. We observed that the Department has established satisfactory basic controls over the megaproject expenditures. However, a major question remains: who is protecting federal interests, above and beyond these basic expenditure and cash management controls?

14.29 Expenditure and cash management controls, while important, will not by themselves ensure that resources are managed well. Our Office has consistently said that operations should be carried out with due regard to economy, efficiency and effectiveness, and information should be available to hold managers accountable for their use of resources.

14.30 In our opinion, if the government intends to continue to participate in multi–jurisdictional, multi–partner, commercial ventures without federal project management, there is much that it can learn from the current energy megaproject arrangements. Specifically, traditional central controls such as those pertaining to major Crown projects are not appropriate for this type of project because they apply only where the federal government operates or controls the project. Clearly, the federal government does not operate or control the energy megaprojects, and we found that central agency policy and minimum control requirements appropriate to such arrangements were lacking.

14.31 It is prudent and important to clarify and elaborate policy requirements that protect both the financial and non–financial federal interests in these kinds of projects. This is largely a central agency responsibility because departments other than Energy, Mines and Resources also deal with similar funding matters. In our opinion, central agencies need to have criteria and guidelines for protecting the public interest, and for rendering accountability on value received for the expenditure of public funds, by those departments and agencies responsible for funding such projects. These criteria and guidelines would have to be flexible to accommodate the diversity and complexity of the megaproject arrangements.

14.32 Treasury Board Secretariat, in conjunction with the Office of the Comptroller General, should elaborate minimum policy requirements appropriate to shared or joint venture arrangements for large–scale projects involving other jurisdictions and/or the private sector.

Improvements are needed in departmental project monitoring

14.33 The Department says in its *1992–93 Main Estimates Part III* that it "negotiates and monitors megaproject agreements with private sector proponents and provincial governments". We reviewed the work of departmental

The Department has established satisfactory basic controls over megaproject expenditures, but who is protecting federal interests above and beyond expenditure and cash management controls?

staff responsible for monitoring the energy megaprojects.

14.34 The Department has a Monitoring Unit with the following responsibilities:

- manage the financial interests of the federal government in energy megaprojects;
- monitor the physical progress of megaprojects;
- report on the megaprojects; and
- obtain legal authorities and opinions.

The Monitoring Unit also has responsibility for co–ordinating information on the megaprojects for other units in the Department, and with other federal departments. The Frontier Lands Management Branch of the Department also monitors information on benefits from Hibernia and the Bi–Provincial Upgrader and receives environmental monitoring data for Hibernia.

14.35 In examining the nature of monitoring and co–ordination by the Department of Energy, Mines and Resources for the Hibernia and Bi–Provincial Upgrader projects (which were still under construction at the time of our audit), we identified the involvement of other federal departments and agencies, as well as the Canada–Newfoundland Offshore Petroleum Board (a joint federal–provincial body). Much of the environmental and benefits monitoring is done by these other departments and agencies. The departmental Monitoring Unit receives some information directly from the Project Operators. However, the Department has explained that it relies to the maximum extent possible on the mandates and competence of other departments and agencies in monitoring the environmental and benefits aspects of energy megaprojects.

14.36 The Department of Energy, Mines and Resources arranged for the Department of Industry, Science and Technology and the Atlantic Canada Opportunities Agency to be involved in monitoring industrial benefits associated with the Hibernia project contracts. Western Economic Diversification Canada co–ordinates the federal monitoring of economic benefits for the Bi–Provincial Upgrader. The Department of Employment and Immigration is monitoring employment benefits arising from the Hibernia and Bi–Provincial Upgrader projects. The Department of Industry, Science and Technology also monitors the industrial benefits from the Bi–Provincial Upgrader project.

14.37 Although the Department has developed some elements of a system for monitoring and co–ordination, these elements do not constitute a clearly articulated approach to monitoring. Most of the arrangements to co–ordinate monitoring and to exchange related information with other departments and agencies lack substantive, well–documented direction. For example, in some memoranda of understanding with other departments and agencies the Department requests only that "relevant information and advice" be provided to it in a timely manner. We would expect clearer direction on what information the Department required, in what form, and how often.

14.38 The monitoring information provided by other departments and agencies is largely dependent on their separate skills and preferences. We believe that good management practice requires the establishment of minimum standards for required information, to inform and guide individuals in other departments as to what is expected from them. Clearly articulated monitoring requirements would help ensure that:

- monitoring by other parties is taking place as intended; and
- the required gathering, verification and analysis of data are being done by each organization involved.

14.39 Monitoring by Energy, Mines and Resources, as well as by other departments and agencies, is constrained by the provisions of the legal agreements. This relates to a point mentioned in paragraph 14.13, that the megaproject agreements contain limited objectives that do not correspond to many of the publicly stated objectives.

14.40 Another problem in monitoring is that some provisions in the agreements are not specific about intended benefits. For example, clauses pertaining to the awarding of contracts to Canadian firms use terms such as "best efforts", and "technology transfer". What these terms mean in practice, for monitoring purposes, is not clear.

14.41 The Department has taken steps to improve its monitoring of the Hibernia project. It was not satisfied with the information it was receiving about contracting benefits. In January 1992 the federal Minister of Energy, Mines and Resources asked for improved information, and asked the Department to review methods used to monitor and report the information. The Department looked into ways to improve the data. It also looked into obtaining specific interim benchmarks, which would be used as the basis to provide regular reporting on the extent to which the project is on track to achieving the estimated benefits. Interim benchmarks were eventually established in February 1992, well after the project's start in late 1990. No interim benchmarks for industrial benefits were ever established for the Bi–Provincial Upgrader project.

14.42 An external audit was performed in mid–1991 on the benefits information provided for Hibernia. The audit identified numerous deficiencies in the gathering and reporting of Hibernia benefits information. Since then, the Department and the Canada–Newfoundland Offshore Petroleum Board have been working on improvements to the benefits information. No subsequent audit has been done, although one is planned for the fall of 1992. In view of the first audit results and the recent receipt of interim benchmarks, the frequency of the auditing of benefits is open to question. Also, we note that no audit was performed on benefits information from the Bi–Provincial Upgrader. Consequently, in our view, it is not clear that the Department has reliable information about the actual achievement of benefits from these two megaprojects.

It is not clear that the Department has reliable information about the actual achievement of benefits.

14.43 Another key problem we noted in the Hibernia and Bi–Provincial Upgrader agreements was the lack of a connection between performance and payment. Federal payments are based on project expenditures, and not on construction milestones or achievement of certain intended economic benefits that have been specifically identified with these projects. Even if the Department of Energy, Mines and Resources determined through its monitoring efforts that certain intended benefits were not being achieved, it would have no legal basis to stop payments to the projects. Without a direct connection between performance and payment, the payment is in the nature of a grant.

14.44 We recognize that the Department cannot unilaterally resolve all the problems we have noted. In particular, problems with wording in the legal agreements cannot be resolved without renegotiating the agreements. This is not likely to be done, nor would it be necessarily practical at this point for the existing megaprojects. However, there are lessons to be learned for future megaprojects.

14.45 Based on our observations, we do not believe the Department of Energy, Mines and Resources has established a sufficiently rigorous regime for monitoring and co–ordinating federal interests in the energy megaprojects. Both Treasury Board Secretariat and the Department of Energy, Mines and Resources have also missed opportunities to help ensure that federal funds spent on the energy megaprojects are managed with due regard to value for money. The key opportunity to protect federal interests is when the legal agreements are being drafted.

14.46 The Department of Energy, Mines and Resources, together with Treasury Board Secretariat, should examine means of improving both the monitoring regime for energy megaprojects and provisions for ensuring the achievement of intended results.

Department's response: As noted, EMR has already taken steps to improve its monitoring of energy megaprojects. The Department is devoting additional resources to the monitoring function, particularly with respect to industrial and employment benefits. A single focal point is being created within the Department to monitor all aspects of megaproject activity and to provide a sharper focus for the coordination of federal monitoring activities.

14.47 Specifically, in developing the policy requirements as recommended in paragraph 14.32, Treasury Board Secretariat should consider requiring that payments be made only on the basis of corresponding progress in the project and on the fulfilment of specific performance conditions.

Weaknesses in monitoring of environmental recommendations and commitments

14.48 The federal government's 1991 *The State of Canada's Environment* report identifies the east coast of Newfoundland as the most likely spot for an oil spill to occur. The same report says the Hibernia project is viewed as "posing potentially significant threats to local marine life".

14.49 We noted that it is the objective of the Department of Energy, Mines and Resources to advance resource development in a manner consistent with federal environmental objectives. We examined the Department's actions to provide protection for the environment in the Hibernia and Bi–Provincial Upgrader projects. The comments that follow relate to the Hibernia Project except for paragraphs 14.64 and 14.65, which relate to the Bi–Provincial Upgrader.

14.50 Prior to the Environmental Assessment Review and Process Guidelines Order (EARP Guidelines) of 1984, which formalized the federal government's environmental assessment and review process, the Department recognized the importance of submitting the Hibernia project to environmental assessment. Hibernia was formally referred by the Minister of Energy, Mines and Resources to a public panel review in 1980, and the panel report was released in 1985 when the 1984 EARP Guidelines were in effect.

14.51 In 1985 the responsibility for offshore petroleum resource management, including environmental responsibilities, was vested in the Canada–Newfoundland Offshore Petroleum Board (CNOPB) created under the "Atlantic Accord". It was to this Board that the Hibernia panel report, comprising 50 recommendations, was directed for action.

14.52 With reference to the EARP Guidelines, the initiating department ("any department that is, on behalf of the Government of Canada, the decision-making authority for a proposal") was considered to be the CNOPB. The Guidelines clearly state that it is the responsibility of the initiating department to decide to whom the recommendations of the panel are directed, and the extent to which those recommendations would become a requirement of the Government of Canada should the project be approved.

14.53 In 1986 the CNOPB released a decision report that responded to the panel recommendations falling under its jurisdiction. The CNOPB clearly indicated in writing, however, that several recommendations fell outside its mandate and that it was "drawing them to the attention of the appropriate authorities". At the time of our audit, no attempt had been made to determine the fate of several of these outstanding recommendations. It is not clear who is responsible to do this.

14.54 In 1988 the decision to proceed with the Hibernia project was made by Energy, Mines and Resources as the funding department. This presumably made it an initiating department as described in the 1984 EARP Guidelines. At this point in the project's history it became unclear, however, which was the lead initiating department – Energy, Mines and Resources or CNOPB?

14.55 We did not find the federal government's 1984 EARP Guidelines to be particularly helpful in this respect. For example, when there are several "initiating" departments, the Guidelines do not require identification of a lead agency. Such a lead agency would ensure, in co-operation with other bodies concerned with the project, that all panel recommendations were considered by the appropriate ministers prior to any further action on the project. Should the decision to proceed then be taken, the lead agency would ensure that those recommendations accepted were incorporated into the design, construction and operation of the project. It would also ensure that suitable implementation, inspection and environmental monitoring programs were established.

14.56 Recommendations from the Hibernia panel were addressed to several federal and provincial departments and agencies, including the federal departments of Energy, Mines and Resources, Environment, Transport and Fisheries and Oceans. The panel recommendations included the establishment of ice management systems, weather forecasting systems, environmental monitoring programs and oil spill contingency plans.

14.57 An important recommendation was not subsequently addressed. It was that government should develop an overall strategy for implementing the panel recommendations considered necessary to the success of the project, identifying appropriate funding levels and sources.

14.58 Whether or not the EARP Guidelines provided clear direction on the treatment of the Hibernia panel recommendations, it is our opinion that, given the importance the federal government attaches to environmental assessment, the following matters should have been fully addressed but were not: how the panel's recommendations were to be dealt with; who was responsible for seeing that this occurred; and that all decisions were documented and taken into account in making the final decision whether or not to proceed with the project.

14.59 In 1990 there were two significant changes to the Hibernia project: modifications in the project design, and a change in the construction site for the project platform. The CNOPB felt that the changes in project design constituted a new plan for development, which required its approval. The CNOPB carried out a detailed review and submitted its decision to the respective federal and provincial energy ministers.

14.60 Energy, Mines and Resources decided that both the design modifications and the change in the platform construction site required review under the 1984 EARP Guidelines. Energy, Mines and Resources was identified as the lead initiating department and it co-ordinated departmental reviews and environmental assessments, which resulted in two separate screening decisions. In both decisions it was concluded that the potential adverse environmental and directly related social effects were insignificant, or

No single organization could provide an overall status report on the environmental protection measures for the Hibernia project.

mitigable with known technology. There were, however, several additional environmental commitments, beyond the fifty original Hibernia panel recommendations, contained within these screening decisions.

14.61 We note that the EARP Guidelines do not provide specific direction with respect to following up on panel recommendations accepted by the Minister, or on any commitments made in the environmental screening decisions mentioned above. When we interviewed the various departments and agencies involved with Hibernia, no single organization could provide an overall status report on the environmental protection measures.

14.62 We would have expected that Energy, Mines and Resources, as the funding department, would have at its disposal up–to–date and complete information on the status of accepted environmental assessment recommendations and commitments. We found no mechanism to provide such information, other than ad hoc telephone calls and meetings.

14.63 For the Hibernia project, and all future projects of this nature, the Department of Energy, Mines and Resources should monitor and record the status of those environmental recommendations and commitments accepted by the Minister.

Department's response: *The status of all environmental recommendations, conditions and commitments for the Hibernia project has been documented by the Department. With the co-operation of the proponent and those government departments and agencies having environmental regulatory responsibilities for the Hibernia project, a comprehensive environmental monitoring system has been developed and will be maintained.*

14.64 For the Bi–Provincial Upgrader, we found that the Department also does not have adequate information about compliance with the terms and conditions of environmental approval. The Bi–Provincial Upgrader environmental assessment was completed in 1991, with federal terms and conditions of approval. We would have expected a better information tracking system, given the evolution of the federal government's approach to environmental assessment and review since the introduction of the 1984 EARP Guidelines.

14.65 The Department has informed us that it is in the process of staffing a new group with environmental responsibilities, which should address the concerns noted above for the Bi–provincial Upgrader project.

14.66 Although we note that the Hibernia project was initiated prior to the 1984 EARP Guidelines, which raises questions as to the Guidelines' applicability, we feel that Energy, Mines and Resources needs to place more emphasis on its monitoring of environmental recommendations and commitments, for the following reasons:

- The EARP Guidelines now have the force of law, given the Federal Court's decision of 28 December 1989 on the Rafferty–Alameda Dam project, which found the Guidelines to be binding on ministers of the Crown.
- The Supreme Court decision of 23 January 1992 on the Oldman River Dam Project confirmed that the EARP Guidelines are, indeed, law.
- The government has made a commitment, as announced in December 1990 in its "Green Plan", to the environmental assessment and review of new projects, policies, programs, legislation, and current initiatives. This is a key element in the federal government's approach to environmental stewardship as a means of attaining sustainable development.

- The new Canadian Environmental Assessment Act (Bill C–13) was given Royal Assent on 23 June 1992 and is expected to be proclaimed early in 1993, replacing and improving on the 1984 EARP Guidelines.

14.67 We will continue to follow the implementation of the new environmental legislation, regulations and operational guidelines to determine whether they address the weaknesses we identified.

Opportunities exist to improve effectiveness measurement

14.68 Effectiveness measurement helps answer the question: are the megaprojects producing the results they were intended to produce? We have already observed that the objectives for the megaprojects are not clear, and this makes it difficult to determine whether the intended results are being achieved. In addition, many of the estimates of anticipated socio–economic benefits, such as job creation and contracting to Canadian companies, were developed by the firms that proposed the Hibernia and Bi–Provincial Upgrader projects. Energy, Mines and Resources did not develop a set of independent estimates of its own. The Department did review the estimates prepared by the private sector firms, but the extent of its review is not clear. We also found it difficult to determine all of the underlying assumptions in those estimates.

14.69 The Department does have arrangements in place to monitor certain direct effects, such as direct employment resulting from these projects. However, these arrangements do not examine the wider employment impacts and other socio–economic effects, such as the effect on housing and business in the surrounding communities. For Hibernia, when proposing the project, the firms estimated these wider employment impacts to be significantly greater than the direct effects.

14.70 At the time of our audit, the Department had not established any framework setting out the performance indicators and a plan to collect and interpret performance data for any of the megaprojects. Such evaluation frameworks, according to Treasury Board program evaluation policy, should be prepared as early as the initial design phase. In our opinion, had the Department undertaken to develop evaluation frameworks for each of the megaprojects, it would have identified some of the problems we have noted. The frameworks would have provided an opportunity for the Department to address the clarity of objectives, the measurement of both direct benefits and wider effects, and the extent of the need to establish systems for gathering essential data on an ongoing basis. All these steps are necessary to determine what, exactly, the megaprojects are achieving.

14.71 In addition to the above considerations, we undertook an examination of evaluations actually undertaken and finalized by the Department covering earlier financial incentive measures for the energy and mining sectors. Although these programs had a different orientation from the megaprojects, they too represented a significant level of assistance to the sector and had a focus that included the more productive development of Canada's energy resources. These programs have been discontinued, but we thought it was important to examine the Department's evaluation of their effectiveness. Our purpose was to identify lessons learned about the Department's approach to evaluation in the energy sector that would be useful to any future evaluation of the megaprojects. Our Office has commented before, in 1983 and again in 1985, on the Department's evaluation of financial incentive measures for the energy sector. This year we looked in depth at the evaluations of the Petroleum Incentives Program (PIP), the Canadian Exploration and Development Incentive Program (CEDIP), and

Evaluations of prior incentive programs had significant gaps in what they reasonably and appropriately could have been expected to cover.

the Canadian Exploration Incentive Program (CEIP), completed in 1985, 1991 and 1992 respectively.

14.72 The Department is to be commended for developing feedback information on program effectiveness in these important areas, which are complex to measure. Our examination indicated that the information generated should be particularly useful for improving the operational performance of programs of this type. However, in assessing overall program impacts and effects there is still some need for improvement. Measuring effectiveness is important in accounting to Parliament for moneys that have been voted. It also can provide important feedback, based on experience gained, for any future program initiatives.

14.73 As to the timing of the evaluations, they were undertaken for all three incentive programs, PIP, CEDIP and CEIP, after cancellation of the programs had been announced. The Department points out that CEDIP and CEIP were cancelled earlier than anticipated. Our point is that timeliness of evaluation is crucial, and in the cases of PIP and CEDIP there was adequate time to proceed earlier with an evaluation. In our view, it would have been reasonable to do so given the stage of the programs' implementation, the large amounts of money involved and, in the case of CEDIP, the temporary nature of the program.

14.74 We also reviewed the quality of the evaluations undertaken for all three incentive programs and found deficiencies in the way the evaluations addressed cost–effectiveness issues. This reduced their usefulness and did not give a clear picture of program results.

14.75 The CEDIP evaluation report did not adequately assess the cost–effectiveness issues arising from evidence that the program may have failed to produce any increase in investment or drilling by large firms. Those companies received some 41 percent of the incentives paid during the entire program.

14.76 In our view, in the CEIP evaluation report, the overall estimate of one of the program's key intended effects (increasing financing for exploration companies) was not adequate. This was because of an absence of explanatory evidence in the analysis, and the fact that many firms themselves could not estimate the extent to which their financing had been increased as a result of the program. Further, the evaluation contained another important gap. It ignored the cost–effectiveness issues arising from the Department's own conclusions about the assisted firms. The Department concluded that nearly 40 percent of companies surveyed (who received financial assistance under the program) " were no longer in existence" by the time of the evaluation follow–up. The evaluation did not address the question of what the program achieved in such cases.

14.77 The PIP evaluation also had significant gaps in what it reasonably and appropriately could have been expected to cover. This is cause for concern in view of the extremely high expenditure of public funds involved ($7.33 billion between 1981 and 1988). The evaluation did not provide a meaningful cost–effectiveness analysis of the program. For example, the evaluation scope did not address whether other program alternatives could have encouraged the lower–cost and/or less risky development of oil supplies. Further, the evaluation did not adequately address the question of the program's contribution to increasing Canada's recoverable oil reserves, indicating that there was only limited information available at the time. Yet this is a critical question related to cost–effectiveness and value for money for a program involving significant levels of expenditure. There is no evidence that the Department pursued this issue further in any subsequent evaluation activity.

14.78 To measure the effectiveness of the Hibernia and Bi–Provincial Upgrader megaprojects, the Department of Energy, Mines and Resources should:

- **complete an evaluation framework for the Hibernia project as soon as possible and assess the effectiveness implications of the data it is collecting as part of its monitoring process;**
- **proceed with in–depth program evaluations at an appropriate time when the effects of the projects are measurable; and**
- **evaluate both direct and indirect impacts of these megaprojects to determine their full extent and costs and to compare them to intended objectives and estimated costs. The evaluations should address key questions about achievement of objectives and cost–effectiveness** (see Exhibit 14.5).

Department's response: *With respect to the Hibernia project, EMR will undertake, at an appropriate time, the evaluation as proposed under the "Terms and Conditions of Contribution/ Management Arrangement" approved by the Treasury Board.*

In accordance with its Program Evaluation Plan for the period 1992 to 1995, EMR is determining the evaluation requirements for the megaprojects. The nature of evaluations will depend on the usefulness of information for decision making for ongoing projects and on the need for additional reporting for accountability purposes.

Improved information is needed for Parliament and the public

14.79 In paragraph 14.14 we said that parliamentarians should be able to question the Department about results achieved from the megaprojects, especially given the magnitude of the dollars, benefits and risks involved. Public expectations for these projects have been raised through extensive publicity.

14.80 We reviewed various ways the Department reports to Parliament and to the public. These include press releases, appearances before parliamentary committees, the Department's annual Report, the Public Accounts of the Government of Canada and Part III of the Main Estimates. We chose to focus on the reporting of the megaprojects in Part III. This way, our audit work was consistent with, and contributed to, a separate government–wide study on Information for Parliament (see Chapter 6).

14.81 Our review of the megaproject information in the Department's Part III for the past three years indicates that the following key information was not reported, or was only partly reported:

- project objectives and benefits;
- full federal financial commitments;

Exhibit 14.5

Benefit Assessment of Megaproject Investments

Evaluation Questions/Issues

(1) **Job Creation**
How does the total number of jobs actually created as a result of the megaprojects (both direct employment and other wider employment effects on the local areas concerned) compare with what was originally forecast by the private sector?

(2) **Technology Transfer**
What form was the technology transfer supposed to take through the megaprojects? To what extent has it occurred? What have been the benefits?

(3) **Regional Development**
What has been the cost for the federal government per job created through the megaprojects compared to the costs of other regional development approaches? What has been the impact on industrial diversification in the areas involved?

(4) **Security of Supply**
How cost–effective are the megaprojects in developing additional oil reserves compared to other options within Canada to enhance security of supply? What have been the effects on Canada's balance of payments in the oil and gas sector?

(5) **Fiscal Effects**
To what extent have the megaprojects reduced dependence on federal–provincial equalization payments and what has been the return to the federal government on its own direct investment in these projects?

- project progress and performance (actual results versus those planned);
- status of environmental commitments; and
- sources of additional information.

Reporting of non–financial aspects of the megaprojects is virtually non–existent.

14.82 Although the Department acknowledges that this information is not all reported in its Part III document, it says that it would provide more information upon request, particularly to parliamentarians.

14.83 In addition, Part III reporting of megaprojects is disjointed. One must look to various references, and bring together bits and pieces of information. A prime example of disjointed and incomplete reporting is the information provided on the Bi–Provincial Upgrader in the 1992–93 Part III document. The federal funding of significant construction cost overruns on this project is not clearly identified or explained, and the liabilities to the government as an equity participant are not revealed.

14.84 We recognize that a balance must be reached between too much information and too little. We are not advocating a massive expansion of information on the megaprojects. But we do believe that reporting on them could be improved.

14.85 The Department's responsibilities for the megaprojects go far beyond matters for which information is currently reported in public documents. This information primarily relates to financial aspects. However, the megaprojects have significant non–financial objectives to consider, including economic benefits as well as environmental impacts. The reporting to Parliament and the public on these non–financial aspects is virtually non–existent.

14.86 The Department of Energy, Mines and Resources should provide better information to Parliament and the public on both the financial and non–financial results of federal spending on the megaprojects. Reporting should explain, as a minimum:

- **what support the Department is providing to the megaprojects;**
- **what it plans to do in the future; and**
- **what results the megaprojects have achieved, and how much they have cost to date and will cost to complete.**

Department's response: *Within the OCG guidelines for the preparation of Part III of the Estimates, EMR's reporting of energy megaprojects will be improved in an effort to address the points raised by the Auditor General.*

Exhibit 14.6

HIBERNIA OFFSHORE DEVELOPMENT PROJECT

Background

- After years of negotiation, work on Hibernia began with the signing of binding legal agreements between the project sponsors on 14 September 1990 and passage of the Hibernia Development Project Act in November 1990.
- The Hibernia oilfield, discovered in 1979, is 315 kilometres southeast of St. John's, Newfoundland. It is estimated to contain 525 million barrels of oil, recoverable over 18 years with a peak average daily production rate of 110,000 barrels.
- Initial respective equity interests were: Mobil, 28.125 percent; Gulf, 25.0 percent; Petro-Canada, 25.0 percent; and Chevron, 21.875 percent.
- Gulf withdrew from the partnership on 4 February 1992. Work has been slowed down until a new partner can be found.
- Production is now expected to begin in late 1997.
- Project construction cost prior to start of production is estimated to be $5.2 billion. Of this amount, the Government of Canada will: contribute 25 percent of construction costs to a maximum of $1.040 billion; guarantee loans on 40 percent of construction costs to a maximum of $1.660 billion; provide interest assistance, if required, to a maximum of $300 million and provide temporary financing on 40 percent of construction costs over $5.215 billion to a maximum of $175 million.

- The production facility is to consist of a massive, reinforced concrete base resting on the ocean floor. This type of platform is known as a gravity base structure.
- As of 30 June 1992, $644.5 million had been spent on the project. Canada had contributed $160.3 million and had guaranteed loans totalling $174.6 million.

THE BI-PROVINCIAL UPGRADER

Background

- The Bi-Provincial Upgrader Project was initiated on 2 September 1988.
- The governments of Canada, Alberta and Saskatchewan jointly signed an agreement with Husky Oil Limited to finance, build and operate a crude oil upgrader near Lloydminster, on the Alberta-Saskatchewan border, at an original estimated cost of $1.267 billion. The latest cost estimate is $1.632 billion.
- Respective equity interests are: Canada, 31.67 percent; Husky, 26.67 percent; Alberta, 24.17 percent; and Saskatchewan, 17.5 percent.
- As a result of negotiations regarding cost overruns, the federal commitment has increased from $401 million to $530 million. This now exceeds the federal equity interest of 31.67 percent.
- The Upgrader has been designed to convert heavy oil and bitumen to synthetic crude oil for eventual processing into usable petroleum products.
- The expected capacity of the upgrader is 46,000 barrels of synthetic crude oil per day. Production is expected to begin by December 1992.

NEWGRADE UPGRADER PROJECT

Background

- On 23 December 1986 an agreement (the Project Agreement) was signed by Consumers' Co-operative Refineries Limited and the governments of Saskatchewan and Canada for construction of a heavy oil upgrader in Regina, operated by NewGrade Energy Inc.
- The Project Agreement outlined the terms and conditions under which Canada would provide loan guarantees for approximately 35% of project costs to a limit of $275 million. Project costs of approximately $795 million include a capital cost of $700 million plus financing costs.
- The project commenced operations in November 1988 and experienced operational start-up problems.
- The Upgrader has been operating at or beyond its design capacity of 50,000 barrels per day.

Chapter 15

Department of Indian Affairs and Northern Development

Indian Forest Management

The Manitoba Northern Flood Agreement

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Department of Indian Affairs and Northern Development

Assistant Auditor General: Elwyn Dickson
Responsible Auditor: Larry Ting

Main Points

INDIAN FOREST MANAGEMENT

15.1 The Department of Indian Affairs and Northern Development (DIAND) has not fully discharged its statutory responsibilities with regard to Indian forest lands.

15.2 The Timber Regulations established by DIAND to carry out these responsibilities are inappropriate and unenforceable.

15.3 Band consent is needed for entering reserves and for issuing logging permits, but the Crown has title over reserve lands. Management of reserve forest thus requires the co–operation of both parties.

15.4 DIAND and band councils lack adequate information to make effective decisions about Indian forest lands.

15.5 Significant sustainable social and economic benefits would be possible if Indian forests were better managed.

THE MANITOBA NORTHERN FLOOD AGREEMENT

15.6 Under the 1977 Northern Flood Agreement (NFA), the governments of Canada and Manitoba and Manitoba Hydro agreed to compensate five Indian bands for the adverse effects of hydro–electric development projects undertaken by Manitoba Hydro.

15.7 According to DIAND, the adverse effects included the flooding of up to 2,134 square kilometres of land, including 67 square kilometres of reserve land that is home to 10,000 status Indians.

15.8 The NFA is being implemented by a dispute resolution process rather than by a co–ordinated, co–operative effort by all parties. This is detrimental not only to the NFA parties, but also to the taxpayers of Canada, who ultimately pay the costs.

15.9 Certain environmental considerations have not been properly addressed, despite the federal government's knowledge of actual or potential dangers.

15.10 DIAND and other federal departments have spent over $115 million under the NFA (mostly since 1988), but they have not captured the total costs to date and they do not know what these are likely to be in the future. Under a 1990 proposal, the federal government would pay the bands an additional $78 million, not including ongoing normal funding.

INDIAN FOREST MANAGEMENT

Introduction

15.11 According to Forestry Canada (FORCAN), the productive forest lands on Canada's Indian reserves total approximately 1.4 million hectares (see Exhibit 15.1). Of the 603 bands living on reserves, approximately 240 have forest areas in excess of 1,000 hectares.

15.12 Most reserve forests represent a major opportunity for social and economic development for Indian bands. Forests, no matter how small, are often the single most important asset of many bands. They are the base for many renewable resources, including timber, forage, and wildlife, and are crucial to the supply of fresh water and clean air. In fact, forests provide more than fuel, shelter and food to native people. They are an essential ingredient in the cultural and spiritual well–being of the Indian population.

15.13 Larger forest holdings, if properly managed, could provide employment and yield a steady income to band members. A number of reserve forests are economically accessible to industries that use wood.

Indian forests could provide employment and yield a steady income to Indian bands.

15.14 The vast majority of on–reserve Indians live in areas remote from urban centres. They depend heavily on the resource base of the reserves and the limited employment opportunities in the immediate vicinity. Significant improvements in the social and economic conditions of Indians can come about only when development of the natural renewable resources is sustainable.

15.15 According to FORCAN, the forests of many reserves are seriously depleted due to several decades of neglect and lack of forest management. The main causes are indiscriminate logging, fire, lack of reforestation and inadequate site tending.

Forests of many Indian reserves are seriously depleted due to decades of neglect and lack of forest management.

15.16 The Indian Act and the Indian Timber Regulations establish DIAND's statutory responsibility for Indian timber and reserve forests. The extent of this responsibility is subject to many interpretations, from acting as a trustee (fiduciary) to simply issuing licences and permits to cut timber on reserves.

15.17 FORCAN helps the Department fulfil its responsibility by providing expertise, leadership and funding in forest management matters. Approximately $17 million was made available for 1984 to 1990 under the federal–provincial Forest Resource Development Agreements (FRDA). This amount has been increased to $30 million for 1991 to 1995. We have not carried out any audit on the activities by FORCAN relating to Indian Forests.

15.18 As a result of its evaluation study on Indian Forest Resources in 1988, DIAND entered into a Memorandum of Understanding with FORCAN to establish co–ordinated working relationships and common objectives respecting Indian forestry programs. Notwithstanding this arrangement, DIAND retains ultimate accountability for its statutory responsibilities.

Audit Scope

15.19 In this audit we examined the way DIAND interprets and carries out its statutory role for the disposal of Indian timber. We also looked at its role in the management of reserve forests in the provinces. We did not include forests of the Yukon and Northwest Territories.

Audit Criteria

15.20 For DIAND to carry out its responsibility for managing the disposition of timber efficiently and effectively, it should have:

Exhibit 15.1

Area of Indian Forest Lands (in thousands of hectares)

Newfoundland	0.2
Prince Edward Island	0.5
Nova Scotia	8.1
New Brunswick	13.1
Quebec	297.9
Ontario	396.9
Manitoba	93.4
Saskatchewan	243.0
Alberta	176.2
British Columbia	155.9
Total	1,385.2

- a clear statement of the nature and the extent of its responsibility (i.e. as an agent or as a trustee);
- a policy and procedures that provide for the discharging of its responsibility;
- regulations that are consistent, appropriate and enforceable;
- adequate quality and quantity of resources;
- adequate and appropriate data and management information for decision making and managing; and
- adequate and appropriate provision for periodic reports to Parliament and the bands.

Observations and Recommendations

Lack of Clear Mandate

15.21 The mandate of the Department for granting permits and licences for Indian timber and the management of reserve land is stated in the Indian Act.

15.22 The Indian Act clearly states that the reserves are held by the Crown for the use and benefit of the Indian bands.

15.23 Section 18(1) of the Indian Act states: "...reserves are held by Her Majesty for the use and benefit of respective bands .... the Governor in Council may determine whether any purpose for which lands in a reserve are used or are to be used is for the use and benefit of the band."

15.24 "Reserve" is defined by the Act as: "a tract of land [including forests], the legal title to which is vested in Her Majesty, that has been set apart by Her Majesty for the use and benefit of a band...."

15.25 Furthermore, section 57 under the part of the Act entitled "Management of Reserves and Surrendered Lands" empowers the Governor in Council to make regulations "authorizing the Minister to grant licences to cut timber on surrendered lands or, with the consent of the council of the band, on reserve lands; and imposing terms, conditions and restrictions with respect to the exercise of rights conferred by licences granted."

15.26 The mandate for the disposition of timber on reserves is clearly stated. The precise meaning of other aspects of Indian forest management has been subject to different interpretations for years. The basis of the debate is whether the mandate represents a legal obligation or comprises discretionary activity. The Department should clarify its responsibilities with regard to these aspects of forestry management.

15.27 Without such clarification, it becomes almost impossible to determine whether resources are being used for the purpose required by the statute or whether implementation of the Department's responsibility is consistent across the country.

15.28 DIAND, in consultation with Forestry Canada and aboriginal forestry groups, should develop a statement that delineates its responsibilities and those of the bands in relation to Indian reserve forests and outlines an operating plan to guide its activities.

Lack of Management Objectives

15.29 In order to meet its statutory obligation in managing the disposition of timber, we would expect the Department to have a policy that clearly states its objectives, responsibilities and accountability, as well as strategies for accomplishing its objectives. Following the development of such a statement, DIAND would need to consult with First Nations to develop a plan and procedures for discharging its responsibilities.

15.30 We found that the Department does not have a policy or a plan to specify how it would fulfil its obligation to ensure that all timber revenues due to the bands are collected and deposited to their accounts. Numerous attempts by DIAND staff in some regions to develop a forestry manual have never been carried through by the Department.

15.31 For any native forestry program to be socially, economically and environmentally successful, it must have the bands' full participation in its design and administration. DIAND has provided financial resources and technical support to the Intertribal Forestry Association of British Columbia and the National Aboriginal Forestry Association for their development of legislative initiatives. A long–term perspective is required for managing the harvest of timber on a sustainable basis and for determining how the activities will be funded.

15.32 DIAND should, in co–operation with Indian bands and FORCAN, develop, communicate and implement a clearly stated Indian forest policy that reflects the interests of both the Indian communities and the federal government.

Regulations Ultra Vires

15.33 The Indian Act authorizes DIAND to establish regulations that enable it to fulfil its responsibility. The regulations should be valid (not ultra vires), appropriate and enforceable. In 1982 the Standing Joint Committee of the Senate and House of Commons on Regulations and other Statutory Instruments stated that several of the provisions in the Indian Timber Regulations had serious shortcomings. They were, and still are, inconsistent with the Indian Act and in conflict with the Charter of Human Rights. The Department acknowledges these shortcomings but has not put recommended changes into effect.

15.34 DIAND has directed its regional offices not to use the sections of the regulations that are deemed to be ultra vires. The Department informed us that only non–controversial amendments to the sections will be included in an omnibus regulatory change bill in the fall of 1992.

Regulations Outdated

The Indian Timber Regulations are outdated and inadequate for the proper management of Indian forests.

15.35 The Indian Timber Regulations were enacted in 1954. At that time forestry was considered to be synonymous with logging. Reforestation was left to nature. The regulations are silent on virtually all of the modern forestry practices that would ensure harvesting of Indian timber on a sustained–yield basis. They are also inadequate for the proper management of resources that are significantly affected by forestry operations, such as water and wildlife. Furthermore, preservation of the natural habitat is a vitally important factor in the agricultural, cultural and spiritual practices of Indian bands.

Inhibition of Joint Ventures

15.36 Many of the smaller reserve forests are not economically viable management units. Bands with a small forest base need to expand beyond the boundaries of their reserve forests and manage blocks of provincial Crown lands as well. The Indian Timber Regulations inhibit such joint ventures because of the contrast in regulatory regimes on and off the reserves. In one situation, a band was able to take advantage of an opportunity offered by a province to obtain a "tree farm licence" only through an Order–in–Council delegating reserve forest management rights and responsibilities from DIAND to the province. This delegation was subsequently challenged by the Standing Joint Committee of the Senate and House of Commons on Regulations and Other Statutory Instruments.

Inconsistent Implementation of Regulations

15.37 Implementation and enforcement of the Indian Timber Regulations vary widely across the country. In some provinces they are not applied at all; in others they are applied with varying degrees of effectiveness. In one province, the regional DIAND staff designed detailed permits for logging companies to overcome the shortcomings of the regulations. These permits stipulate the standards for logging and the requirement to comply with the provisions and regulations of the provincial Forest Act dealing with timber scaling and marking. These permits also include environmental protection provisions.

15.38 DIAND should consult with the Indian communities and institutions when revising the Indian Timber Regulations to ensure that they are appropriate for modern multi–use forest management practices and reflect the interests of all parties.

Lack of Appropriate Resources

15.39 DIAND needs to ensure that the required expertise is available to carry out its statutory responsibilities for the disposal of Indian timber. We believe that there is a shortage of departmental staff with either professional or technical training in forestry. There is one staff member for the entire Maritime area, one in each of Quebec, Ontario, Alberta, Manitoba and Saskatchewan, and two in British Columbia. Many of these staff members have other duties and little time for preparing and issuing permits or licences.

15.40 DIAND needs to determine what resources are needed and what can be made available, either from internal sources or through other federal departments or Indian institutions, to adequately discharge its responsibilities for Indian forests. Based on data collected by FORCAN in 1988, total expenditure per hectare of productive forests on Indian land is about half the average for Canada. This is a large discrepancy in investment.

15.41 There is virtually no enforcement, inspection or ensuring of compliance to terms and conditions in permits or licences. Furthermore, penalties prescribed by the Act for contravention of regulations are too light to act as a deterrent. Many bands simply ignore the Act and log timber for sale as they see fit. In some instances, individuals from outside the bands have illegally harvested timber on Indian lands. There is no existing process that allows a band council to effectively deal with this situation. Bands must request that the Minister prosecute for illegal removal of timber. The result has been a steady depletion of forest on most reserves and an ensuing loss of revenue.

15.42 Furthermore, DIAND often has no record of timber cuts, either because it is unaware of the operations or because its staff have insufficient time or resources to effectively monitor them. The Department, therefore, cannot ensure that reasonable standards of forestry practice are applied or that good value is received for timber that is cut.

15.43 There have been cases where valuable cedar was logged and the contractor did not pay any stumpage, even though a permit was approved and issued by the Department. Performance bonds or holdbacks were not requested, as would be the case in good business practice. In another instance, a permit was issued by DIAND for the harvest of 56 hectares of high–value spruce. The contractor went bankrupt, the wood was burned, and the band lost the $750,000 revenue from its forest.

15.44 DIAND should ensure that adequate expertise, in terms of quality and quantity, is available to enable it to discharge its statutory responsibilities for Indian forests.

Lack of Information

15.45 Section 57(a) of the Indian Act requires the Minister of DIAND to seek the consent of the band council when granting licences to cut and dispose of timber on reserve land. The Minister first has to judge whether or not a proposed licence benefits the band as a whole. Without proper information, DIAND is unable to realistically assess the opportunities and problems of Indian forests. The band council also needs appropriate and adequate information to ascertain whether or not a licence is in its best interests. At a minimum there should be an inventory of the forest and a forest management plan with adequate resources for implementation. In discharging its responsibility, DIAND has to ensure that the timber is sold at competitive prices and that the cutting complies with the band's forest management plan (if it has one).

15.46 In our 1986 annual Report, we recommended, and DIAND agreed, that the Department compile and maintain a complete, accurate and up–to–date inventory of Indian forests. Subsequently, in 1987, DIAND made a commitment to the Public Accounts Committee to have such an inventory completed by 1991 for all bands with commercial forestry potential.

15.47 Most of the current inventories and comprehensive forest management plans are carried out with the assistance of FORCAN and are funded through Forestry Resources Development Agreements (FRDA). FORCAN reports that less than 50 percent of the Indian productive forest land has been adequately inventoried. Exhibit 15.2 provides details of inventoried areas by province.

15.48 According to DIAND, the principal reason for not completing the forest inventories is that many bands have not initiated a request for an inventory, in part because the inventory program has not been actively promoted.

15.49 DIAND, with the assistance of FORCAN and the co–operation of the Indian communities, should complete the forest inventories on Indian reserve lands as quickly as possible.

Less than 50 percent of productive Indian forest land has been adequately inventoried.

Periodic Reporting

Lack of Adequate Reporting

15.50 In order to fulfil its accountability requirements regarding Indian forests, DIAND should obtain pertinent information from the bands and report periodically to Parliament on the performance of all parties concerned. In addition to the basic information normally contained in a performance report, it would be useful to indicate where to obtain additional information, such as an inventory of Indian forest under its management, the status of the development of Indian forest management plans, and descriptions of programs or assistance being offered by federal and provincial government departments. Well–performing band forestry management activities could be included to serve as role models for other bands who are considering investing in forestry development.

15.51 We found that the Department did not regularly report to Parliament on the situation regarding Indian timber and forests.

15.52 FORCAN, which publishes a biennial report entitled "Timber Harvest on Federal Lands" that contains data on timber harvested, stumpage revenue, economic impacts and forest management, also has difficulty collecting accurate data from DIAND or the bands. This is due to the absence of systematic recording and collecting of data for evaluation and planning purposes.

15.53 DIAND should consult with the Indian communities to develop a mechanism for reporting on its statutory responsibility and other aspects of the management of reserve forests and should report regularly to Parliament on the performance of all parties concerned.

Exhibit 15.2

Area of Indian Forest Lands That Have Been Adequately Inventoried (in thousands of hectares)

Newfoundland	0
Prince Edward Island	0
Nova Scotia	7
New Brunswick	10
Quebec	160
Ontario	158
Manitoba	20
Saskatchewan	45
Alberta	104
British Columbia	130
Total	**634**

Benefits from investment in long–term forest management could reduce future federal spending on social assistance for Indians.

Conclusion

15.54 Based on the results of our examination, we concluded that DIAND is not discharging its statutory responsibility for Indian forest management with professional and due care.

15.55 In view of the uncertainty surrounding this issue and an increasing tendency for the federal government to be called to account for its stewardship of Indian interests, the Department needs to review with the various bands the manner in which forest management is carried out. Failure to discharge its responsibilities in this regard could lead to legal action against the Department.

Other Benefits

15.56 Successful management of reserve forests would yield social and economic benefits both to the bands and to Canada. Benefits from investment in long–term forest management could reduce future federal spending on other economic development, health and social assistance programs for the bands.

15.57 Forestry Canada estimates that each thousand cubic metres of timber harvested creates 1.94 jobs in the forest sector and 3.42 jobs in other sectors, providing an economic benefit to society of around $166,000.

15.58 According to FORCAN estimates, the current reported harvest levels on reserve forests represent only 25 percent of the annual potential allowable cut. Indian forests are also growing less wood fibre than they are capable of. Therefore, it appears that existing harvest levels could be increased significantly with improved forest management. In the long term, this could potentially raise the annual harvest to nearly 5 million cubic metres, which would generate log shipments with an estimated value of $200 million annually and prospective direct employment for almost 10,000 people.

Example of Good Investment in Forestry Management

15.59 A few bands are already benefiting from comprehensive forest management. We selected one for reporting that had readily available data on the resultant social and economic benefits.

15.60 In 1981, because of a legal restriction under the Indian Act, the Stuart Trembleur Lake Band had to obtain a federal Order–in–Council and incorporate Tanizul Timber Ltd. to acquire a tree farm licence from the British Columbia provincial government so it could manage forest lands both within and outside its reserve. The licence was awarded for a period of 25 years with provision for replacement.

15.61 The licence covers approximately 47,500 hectares of provincial Crown forest and 2,200 hectares of reserve forest. It allows an annual cut of approximately 132,300 cubic metres. The forestry operations generate between $4 and $6 million annually, depending on the volume cut and market conditions. Stumpage, which averages $10 per cubic metre, generates revenues of approximately $1 million annually for the provincial government.

15.62 At the time it obtained the licence, the band had no experience in either business or resource management; nor did it have equity funding to operate the tree farm. But, with training in various professions and strong, capable leadership, it has overcome these deficiencies. Within a few years, the band has:

- created a stable employment base close to home for its members;
- provided band members with practical job training that could

lead to long–term employment on or off the reserve;

- increased employment and income levels for the band as a whole;
- reduced dependency on federal government support; and
- contributed to immediate and future social and economic benefits for the band and the public in general.

15.63 Tanizul Timber has created employment for five full–time office staff and three full–time forest supervisors and managers. During the logging season, up to 25 people are hired for falling, bucking and operating machinery in the woods. The company also hires four silviculture contractors, who employ up to 50 people to work in various aspects of silviculture. A sawmill under construction will create direct employment for 20 to 25 people.

15.64 The success of a band depends on the extent of community involvement. Bands must be prepared to initiate, develop, implement and administer their own forest management programs. DIAND can expedite the process by supporting native institutions that in turn can assist in the training of native foresters, bringing opportunities to the attention of bands, and citing success stories to demonstrate the potential benefits. In order to carry out a cost–benefit analysis of investments in forestry development, baseline social and economic data are required. The bands or institutions should be encouraged to collect such data so that an evaluation can be carried out.

15.65 DIAND should provide encouragement and support for Indian communities to follow the lead of bands that have undertaken systematic, sustainable development of reserve forests for their social and economic benefit.

Department's response: *The Department's legal obligations are limited by the Indian Act to the regulation of cutting and removal of reserve timber, and compliance with the terms and conditions of any surrender or designation of timber resources.*

In addition to its statutory mandate, the Department plays a development role with regard to Indian forests. This includes the promotion of environmental stewardship and sustainable development and the improvement in the quality of life for native people in Canada. In fulfilling this role, the Department believes it is essential to further develop the ability and capacity of Indian peoples to manager their forests. To this end, the Department has been working closely with Indian groups and Forestry Canada to develop Indian forestry institutions, to assist Indian communities in planning their forestry management programs, to promote forest management and stewardship and, particularly, to encourage Indian communities to harvest timber in accordance with responsible and effective forest management practices.

This close co–operation between the Department of Indian Affairs and Northern Development, Forestry Canada, and Indian groups is reflected in a policy statement, "Sustainable Forests: A Canadian Commitment", which was endorsed by the Canadian Council of Forest Ministers and Indian forestry leaders on 4 March, 1992. The statement includes an action plan on Indian forests.

Since 1990, the Department has been working with Indian forestry leaders on the development of a comprehensive forestry strategy. Part of the strategy includes developing legislation and policies on managing and regenerating Indian forest lands. Department officials are working with representatives of the National Aboriginal Forestry Association (NAFA) on a legislative alternative to the forestry–related sections of the Indian Act. Part of this initiative will include technical amendments to the Indian

DIAND and native institutions should work together to assist bands in developing successful forest management programs.

Timber Regulations. As well, the Department and Forestry Canada have supported the National Aboriginal Forestry Association in developing guidelines and standards to be used by Indian communities to manage their forest lands.

The Department will implement the recommendations of the Auditor General, insofar as they conform to the Department's statutory mandate. The Department will develop, in consultation with Indian forestry leaders and Forestry Canada, a policy and operating plan to outline the Department's responsibilities and guide its activities. The Department will also continue to work with Indian forestry leaders to improve the regulatory environment for Indian forestry. It will put in place appropriate resources to fulfill its statutory responsibilities. Finally, it will report to Parliament on its statutory mandate.

Regarding those aspects of forest management beyond its statutory mandate, the department will work with Indian forestry leaders and Forestry Canada to better define and implement its role.

THE MANITOBA NORTHERN FLOOD AGREEMENT (NFA)

Introduction

The NFA: Its Purpose and Parties

15.66 The Northern Flood Agreement provides a framework for compensating five Indian communities for the adverse effects from various hydro–electric development projects undertaken, or to be undertaken, by the Manitoba Hydro–Electric Board (Manitoba Hydro). The Agreement states that, when it was made, there was uncertainty as to the effects of the Hydro projects and that it was not possible to foresee all the adverse results.

15.67 The Hydro projects, which include the construction of up to 14 power stations and other assorted water control structures, have significantly affected the water levels and/or flows of the Nelson and Churchill rivers and Lake Winnipeg. Four stations had been completed by mid–1988. Hydro estimates that the remaining 10 stations will not be completed until 2050.

15.68 The NFA was signed in December 1977 by:

- the Government of Manitoba (Department of Northern Affairs);
- Manitoba Hydro;
- the Northern Flood Committee Inc. (NFC), an Indian corporation representing the five affected bands — Nelson House, Norway House, Cross Lake, Split Lake and York Factory; and
- the Department of Indian Affairs and Northern Development (DIAND), on behalf of the Government of Canada.

15.69 The Northern Flood Capital Reconstruction Authority (NFCRA), an Indian corporation, was incorporated to manage construction of water and sewer systems as contracted with Canada through a 1988 agreement related to the NFA.

15.70 As well, other federal departments, including Environment, Fisheries and Oceans, and Health and Welfare have been involved in various NFA–related activities.

15.71 The Agreement does not specify an implementation schedule.

The Hydro projects have resulted in major water diversions that have significantly affected five Indian communities.

Financial Data

15.72 According to DIAND, costs or financial commitments incurred by the federal government under the NFA totalled over $115 million as at 31 March 1990. Costs incurred by Manitoba and Manitoba Hydro totalled $65 million. In 1990, these three parties offered to settle their current obligations by paying additional amounts of up to $243 million, including an additional federal government share of $78 million, not including ongoing normal funding. We observe on federal government costs and the

Manitoba Hydro has diverted more than 90 percent of the Churchill River to raise the level of the Nelson River so that it could produce more hydro–electric power (see paragraph 15.73).

offer to settle in paragraphs 15.141 to 15.143.

The Northern Flood Committee has indicated that the projects have resulted in the erosion of the traditional economic base and way of life in the affected communities.

Scope and Physical Impact of the Hydro Projects

15.73 The Churchill and Nelson rivers, major waterways in northern Manitoba, flowed approximately parallel to each other and emptied into Hudson Bay. By 1977, Manitoba Hydro had diverted up to 90 percent of the Churchill River into the Nelson River so that generating stations along the Nelson could produce more hydro-electric power. The level of the Nelson was further raised by regulating the outflow from Lake Winnipeg.

15.74 DIAND acknowledges that the following adverse effects, among others, have occurred:

- flooding of up to 2,134 square kilometres of land, affecting 67 square kilometres of the Indian reserve lands of five communities, home to 10,000 status Cree Indians (see Exhibit 15.3);
- damage to recreational and commercial areas;
- decrease in the quantity and quality of fish, including an increase in mercury toxins;
- contamination of drinking water;
- increased scarcity of wildlife for hunting and trapping;
- hazards in water travel because of low water levels; and
- increased danger in winter travel because of unexpected melting patterns of ice caused by abnormal water levels.

Exhibit 15.3

Lake Winnipeg Churchill–Nelson River Hydroelectric Project Area

PROJECT AREA
Thompson
Winnipeg

Canada's Obligations

15.75 The NFA relates to DIAND's mandate under the Indian Act. Section 35 of the Act permits a provincial body to take or use Indian reserve lands, with the consent of, and subject to, any terms prescribed by the Governor in Council. Section 35 also states that any amount that is awarded or paid in respect of such land shall be for the use and benefit of the Indian peoples.

15.76 The NFA assigns most responsibilities for its implementation to Canada, Manitoba and Manitoba Hydro. Some of these responsibilities are joint, while others are specific to a designated party, depending on the nature and cause of the obligation.

15.77 The NFA states that Indian people who are adversely affected by Hydro projects shall be treated fairly. In the Agreement, Canada and Manitoba acknowledge the need to set forth principles on which compensation will be based.

15.78 The NFA states that Canada, by virtue of its responsibility for Indians and the land reserved for them, is "committed to playing an active role in providing opportunity for the continued viability of the [affected] communities...in making available resources and expertise to the communities in planning and improving [their] social and economic conditions...."

15.79 However, Canada is not alone. Article 2.1 of the NFA states, "...Canada and Manitoba shall take such steps as are necessary to give effect to all of the provisions of this Agreement." Examples of significant obligations include:

- Canada will establish, as Indian reserve land, an area of not less than four acres (1.6 hectares) of land for each acre of affected land. The additional land will be selected by the bands, with the agreement of the parties, from certain areas in Manitoba.
- Canada will provide a continuous supply of safe drinking water to the affected communities. Manitoba Hydro will reimburse Canada 50 percent of its reasonable costs incurred to provide water, providing these costs are attributable to

the adverse effects of the Hydro projects.

- Canada and Manitoba will co-operate to provide the resources required to enable each of the five affected communities to formulate a comprehensive community development plan. The plan shall serve as, among other things, a joint action program, subject to the endorsement of all NFA parties, for the eradication of mass poverty and unemployment and the improvement of physical, social and economic conditions and transportation.

- Canada, Manitoba and Manitoba Hydro will implement the recommendations of the 1975 Study Board concerning the impacts of the Hydro projects. In addition, they will report annually to each applicable band council on the status of the recommendations and will continue to monitor the impacts of the projects.

- The onus is on Manitoba Hydro to establish that its projects did not cause adverse effects where any claims are made in connection with the projects.

- All four parties to the NFA will appoint a single arbitrator to settle claims and other matters that may arise, relating to the NFA.

15.80 The NFA's duration is for the lifetime of the Lake Winnipeg Regulation and Churchill River Diversion projects, including any substantially similar redevelopment of these projects. No termination or target completion date is specified, apparently due to the ongoing nature of the hydro projects.

Audit Objective and Scope

15.81 Our objective was to assess the NFA and its implementation in terms of Canada's compliance with the Agreement and good management practices. We took into account DIAND's legislated responsibilities for the Indian peoples and the effects of the NFA on the applicable bands and on the taxpayers of Canada.

15.82 No conclusions are implied on matters not discussed in this chapter. Although there are necessary references to the other parties, our observations are directed to the federal government participants in the NFA, particularly DIAND.

The nature and scope of NFA obligations have not been interpreted consistently by the parties.

Observations

Ambiguous Terms and Conditions

15.83 Because of the importance of the NFA, we expected that its terms and conditions, and the responsibilities it assigns, would be clear. We believe that clarity is essential for appropriately implementing the Agreement and obtaining accountability for results.

15.84 According to DIAND, Canada's NFA obligations can be categorized as those that are specific to Canada and those that are shared with others.

15.85 We found that several years after the NFA had been signed, DIAND had requested an extensive legal analysis of its obligations. The NFA is about 100 pages long. In 1983, government lawyers issued a 72–page report on the possible interpretations of the agreement. In 1987, a legal consultant under contract with DIAND issued a 200–page analysis of the NFA. This analysis attempted to clarify the nature and scope of obligations under the agreement. It noted that the various parties to the NFA had interpreted it very differently.

Parties to the NFA have taken an adversarial approach in implementing the Agreement.

15.86 Because the NFA includes provision for paying compensation, certain financial information is needed to establish the extent of the parties' obligations. We therefore expected the NFA to include criteria and methods for calculating cost estimates for all significant obligations; deadlines for performance and payment; and clear identification of financial obligations by the respective parties.

15.87 The NFA contains appropriate information for only some of the many obligations specified. For example, with regard to Canada's major obligation to provide a continuous supply of drinking water, with 50 percent funding by Manitoba Hydro, the Agreement does not disclose the costs to be shared, deadlines for drinking water projects and funding, or even the nature of the water supply (such as trucked or piped).

15.88 Hydro's share of water supply costs is based on the portion of such costs that are attributable to the adverse effects of the Hydro projects. However, "adverse effect" has not been defined and no method to determine attribution has been specified.

15.89 At the time of our audit, Canada had paid about $88 million for a drinking water supply system and related requirements. This was done through a separate 1988 contribution agreement pursuant to the NFA, and represents Canada's major expenditures to date. Hydro is not a party to this agreement and has paid nothing, despite its NFA obligation to reimburse Canada 50 percent of the applicable costs. Paragraphs 15.131 to 15.137 discuss disputed water issues involving the obligations of Canada and Hydro.

15.90 Further, because the NFA does not specify a termination date (see paragraph 15.80), the extent of certain obligations specified in the NFA could continue indefinitely.

NFA Implementation Failures

Implementation by arbitration

15.91 Implementation of the NFA has been a lengthy and frustrating challenge for DIAND and probably for the other participants as well.

15.92 Very little action was taken during the first several years after the NFA was signed. The co–operative approach required in the NFA was replaced with an adversarial approach, as evidenced by the extensive use of the NFA arbitration provisions. All parties became claimants or respondents or both, either jointly or separately.

15.93 As of November 1991, the parties had filed over 150 claims with the arbitrator. These included 35 claims filed by the bands against Canada between 1980 and 1991, mostly as a joint respondent with Manitoba and Manitoba Hydro.

15.94 The issues include allegations of non–compliance with the NFA, damages relating to mercury contamination, lack of environmental monitoring and reporting, inadequate drinking water, and failure to take remedial measures as agreed.

15.95 In addition, Canada filed five claims against Manitoba or Manitoba Hydro in 1984. These included a major claim to recover its 50 percent share of costs incurred for the drinking water supply system. Canada estimated that its total capital and operating costs for this water system exceed $160 million. At the time of our audit, this claim was unresolved.

15.96 Of the 40 claims involving Canada as respondent or claimant, eight were resolved, and 32 were under review by the arbitrator or under further negotiation by the parties as of November 1991. All but one of these unresolved claims were filed between 1980 and 1984.

15.97 We are not commenting on the merits or outcome of any claim.

However, we are concerned that the NFA is being implemented by a dispute resolution process rather than by a co-ordinated, co-operative effort by all parties. In our view, this is detrimental not only to the NFA parties, but also to the taxpayers of Canada, who ultimately pay the costs.

15.98 We attribute many of the difficulties to the lack of an implementation plan acceptable to all parties. In our view, such a plan should have been negotiated before the NFA was signed. It should have addressed such matters as:

- strategies, priorities and a timetable for implementation;
- sources of funding for the various obligations;
- an appropriate monitoring mechanism for all parties; and
- criteria and methods for evaluating the adequacy of implementation.

15.99 We noted that, in 1982, DIAND expressed concern about the lack of NFA implementation.

15.100 Moreover, in January 1987, DIAND appeared before the Standing Committee on Public Accounts, regarding our 1986 report on a comprehensive land claim settlement. At that time, DIAND testified that 10 years is "an awfully long time" to determine obligations and implement an agreement.

15.101 In response to a Committee member's question about potential government liabilities in similar agreements, DIAND identified the NFA. Yet, 15 years after signing the NFA, Canada's obligations have not been fully determined. (See paragraph 15.143)

Monitoring deficiencies

15.102 Because of the number of parties to this Agreement and their joint responsibilities, we expected to find a monitoring group with representation from each party to facilitate implementation and encourage compliance to the NFA.

DIAND has not adequately monitored NFA implementation.

15.103 Since DIAND has general fiduciary responsibility in matters relating to the Indian people, we thought that it ought to have exercised a lead role in monitoring. This would also be consistent with the general undertaking of DIAND in the Agreement.

15.104 We found that an interdepartmental committee was established to discuss matters of interest to the various federal departments that may be affected by the NFA. However, no monitoring group was established, and DIAND did not routinely monitor the other parties, or even itself; there were no periodic, summary reports in DIAND on the results of NFA implementation.

15.105 In our opinion, the lack of a co-ordinated monitoring function has increased the tendency towards arbitration and has resulted in additional delays, frustration and costs.

Environmental Issues

Adverse effects and mercury concerns

15.106 The parties acknowledge in the NFA that adverse effects have

Parties to the NFA acknowledge that adverse effects have occurred, and may continue to occur, on the lands, pursuits, activities and lifestyles of the 10,000 residents of five Indian reserves in Manitoba (see paragraph 15.106).

occurred, and may continue to occur, on the lands, pursuits, activities and lifestyles of the residents of the reserves. The onus is on Manitoba Hydro to establish that, when an adverse effect is identified, its projects did not cause or contribute to that effect.

15.107 The federal departments of Environment, Fisheries and Oceans, and Health and Welfare, the Government of Manitoba, Manitoba Hydro and the bands have participated in various studies over the years to determine or monitor adverse effects. One example of a serious adverse effect is mercury contamination in fish.

Unresolved environmental issues have been left to linger in the claims arbitration process.

15.108 In March 1987, a joint Canada–Manitoba study report on mercury in the NFA area disclosed that the occurrence of mercury in some women of child–bearing age exceeded the normal range. It further noted that, although mercury levels in the water were normal, mercury levels in fish along the diversion route were elevated. The report attributed this increase to the effect of Hydro flooding on certain organic material that affects how fish accumulate mercury. The study team estimated that it will take decades for mercury in predatory fish to return to historical levels.

15.109 This actual or potential danger has been studied extensively for many years and was the subject of a claim against Canada, Manitoba and Hydro in 1981. The bands conditionally settled the claim for various periods of time ending in December 1994.

Environmental management approach

15.110 We did not perform an environmental audit; nor did we attempt to second–guess the numerous studies and reports on environmental issues. Instead, we reviewed how DIAND, as Canada's signatory to the NFA, manages environmental matters.

15.111 We expected to find a co–ordinated approach among the NFA parties, under DIAND's leadership, to identify, evaluate and resolve environmental issues relating to the NFA. We also expected that DIAND would have an appropriate plan for implementing its own NFA environmental responsibilities. Without these mechanisms, we believe management effectiveness is reduced and the possibility of non–compliance with the NFA is increased.

15.112 Our review disclosed that various environmental monitoring programs and boards or committees representing the parties were established periodically to analyze issues, perform studies, provide advice and monitor effects of the Hydro projects. However, none of these bodies had the authority to assign responsibilities among the parties and enforce necessary action. Eventually, they disbanded and unresolved environmental issues were left to linger in the claims arbitration process.

15.113 We also found that DIAND did not have a plan for the required environmental monitoring. Furthermore, DIAND had not complied with the NFA requirement to report to the bands annually on the implementation status of recommendations made by the Lake Winnipeg, Churchill and Nelson Rivers Study Board in 1975. Over 40 percent of the 47 recommendations concerning the effects of the Hydro projects were assigned to Canada and other parties for joint implementation.

15.114 These recommendations included the monitoring of ongoing social, economic and ecological impacts related to hydro–electric development. The most recent report filed by Canada covers 11 years ended December 1987. We could find no documented reasons to justify a reporting gap for the four years ended in 1991.

15.115 We believe the continuing effects from the Hydro projects require Canada to continue its reporting. We noted that a claim filed by the bands in 1981 against Canada and the other parties in connection with the recommendations of the Lake Winnipeg, Churchill and Nelson Rivers Study Board was still unresolved as of November 1991.

Attribution of impacts to Hydro projects

15.116 The NFA provides for relief from adverse effects of the Hydro projects. In order to attribute an ecological or other effect to these projects it is desirable to have appropriate information of a "before and after" nature. This would allow the comparison of "baseline" or pre–project development data with data gathered during and subsequent to the construction or development process.

15.117 Other methods of determining changes in the impact area could include post–project comparisons with locations that have similar characteristics but are not developed.

15.118 Opinions on the availability and use of baseline data for purposes of the NFA were inconclusive. Some suggested that since Hydro flooding commenced in the 1970s, baseline data may not have been collected in a satisfactory way. Others believed that meaningful baseline data did not exist at all or that it was incomplete or that it was not analyzed properly. In any event, we found no evidence that a comprehensive environmental impact assessment had ever been performed. We believe that such an assessment is essential for NFA implementation because the purpose of the Agreement is to compensate for adverse environmental impacts.

15.119 We noted that as recently as August 1989, almost 12 years after the Agreement was signed, an Environmental Steering Committee representing all NFA parties expressed concern over the absence of impact statements. The Committee reported that statements of adverse effects were urgently needed for each NFA community. During our audit we found no documented impact statements. DIAND told us that this recommendation of the Committee had not been implemented.

15.120 This means that even if adequate baseline data existed and were properly analyzed, there would be insufficient current information for comparison. Thus, it would be difficult for Hydro to demonstrate, as required by the NFA, that its projects did not have an adverse effect. It would also be difficult for Canada to determine what remedial action or compensation was necessary. (See paragraph 15.79.)

15.121 We are concerned that DIAND proceeded to implement the agreement and financed construction of a major water delivery system, even though it lacked significant information needed to determine its obligations.

The Water System Project

15.122 In May 1988, DIAND, the Northern Flood Capital Reconstruction Authority (NFCRA), the Northern Flood Committee Inc. (NFC) and the five NFA bands entered into an $88.5 million agreement to implement Canada's NFA obligation to provide a continuous supply of drinking water to the bands. As we noted earlier, the NFA does not specify the cost or type of system required to fulfil Canada's obligation.

15.123 Under the May 1988 agreement, the NFCRA was responsible for managing the construction of a major water delivery system for the bands. The objective was to provide fully operational water and sanitation systems, comprising a combination of piped and trucked water services to 90 percent of the housing units on the five reserves. According to the NFCRA, this objective was subject to Canada's recovery of Hydro's share of costs under the NFA. The work involved the construction of municipal infrastructure, housing upgrades and plumbing and bathroom additions for 1,309 housing units.

15.124 The parties agreed that upon execution of this agreement, Canada would be deemed to have met its NFA obligation to provide drinking water. Further, with respect to water obligations under the NFA, there would be no recourse by any party to the arbitration provisions for 20 years.

15.125 DIAND's responsibilities included funding and monitoring the project and approving certain construction–related documentation or activities. DIAND also agreed, subject to parliamentary funding approval, to give the NFCRA any monies it recovered from Manitoba Hydro pursuant to Hydro's obligation under the NFA. This payment would be used, with DIAND's approval, to expand or otherwise amend the scope of the water system.

15.126 At the time of our audit, DIAND had paid most of its $88.5 million commitment. DIAND made payments to the NFCRA which, in turn, paid sub–contractors for their work on the project.

15.127 We enquired as to how DIAND obtained assurance that the NFCRA complied with the agreement, particularly the cost, quality and quantity requirements. We also enquired into the general status of the project.

15.128 We noted that DIAND obtained its assurance of compliance with the agreement primarily from the internal control system used by the NFCRA; from project monitoring status reports received from the federal Department of Public Works; and from the annual audit of the NFCRA financial statements performed by its external auditors.

15.129 While each of the above sources can contribute to a certain level of assurance, they are not, in our opinion, a substitute for a construction audit that would independently assess contract performance regarding cost, quality and quantity requirements. Such an audit would provide DIAND with greater assurance of compliance. We noted the agreement provides for an independent audit at the discretion of either party.

15.130 With respect to the general status of the project, we found that the following major dispute among the parties was still unresolved when we completed our audit.

Three–party dispute

15.131 In April 1984, DIAND filed a claim against Manitoba Hydro requesting, among other things, its 50 percent share of the water system development and operating costs. The amount of this claim was not specified. In October 1988, DIAND estimated that Hydro's liability to Canada under the NFA could reach $80 million. This included Hydro's share of costs under the May 1988 agreement with the NFCRA, to which Hydro was not a party, as well as a share of other expenditures.

15.132 According to DIAND, Hydro believes that its share of water system costs is limited to $300,000. Hydro maintains that it is a federal responsibility to provide safe water to the Indian communities; that the adverse effects of hydro–electric development projects are minor; and that the water system funded by DIAND exceeded what was reasonably required to supply drinking water.

15.133 In September 1991, the NFCRA and NFC, upon providing notice, terminated the May 1988 water agreement after DIAND had almost fully funded the NFCRA under the agreement. In the opinion of the NFCRA and NFC, this termination had the effect of revoking the 20–year release provided to Canada regarding the supply of drinking water (see 15.124).

15.134 The apparent reason for terminating the agreement was that Canada had allegedly not exercised its best efforts, as required under the water agreement, to recover Hydro's share of costs (see 15.79). The NFCRA believed it was entitled to receive any monies recovered from Hydro so that water services could be extended.

15.135 In November 1991, the five bands served Canada with a claim that confirmed the termination of the May 1988 water agreement. The claim requested, among other things, that the arbitrator order Canada to make payments (amount unspecified) to the claimants or provide other relief that the arbitrator may deem to be appropriate concerning Canada's alleged failure to comply effectively with the NFA provisions respecting the supply of drinking water.

15.136 The alleged non–compliance by Canada includes failure to fund various water and sewer line projects in each of the five reserves covered by the May 1988 water agreement. In January 1992, DIAND instructed its legal counsel to defend against the claim.

15.137 Although we are not offering an opinion on the merits or outcome of this dispute, we believe that it illustrates some of the difficulties associated with the NFA and its implementation.

Land Exchange

15.138 Paragraph 15.79 describes the obligations of Canada and Manitoba to compensate the bands by providing four new acres of land for each acre taken or damaged by Hydro. DIAND considers this to be a major obligation.

15.139 In 1979, the bands requested that Manitoba determine the criteria that would be applied in the land selection process. However, the bands and Manitoba could not agree on these criteria. Consequently, with the exception of 149 acres (60 hectares), Manitoba has transferred no land to Canada as required by the NFA. Canada, in turn, has provided only the 60 hectares to the bands as compensation under the NFA. This represents less than one percent of the amount of land promised to the bands subject to the terms of the Agreement.

15.140 In 1984, the bands and Canada filed claims against Manitoba for its alleged failure to meet its obligation to provide new reserve land. Although some progress had been made over the years in identifying and agreeing to suitable land, the claims had not been settled at the time of our audit.

Canada has not fulfilled its obligation to transfer to the bands the amount of land required by the NFA.

Other Matters

Federal government costs

15.141 DIAND has attempted to identify and gather all costs incurred under the Northern Flood Agreement. However, it is aware that not all federal departments involved with the NFA have reported their actual costs.

15.142 Without this information, it becomes more difficult for the government to compare results of NFA implementation to the obligations it undertook in the Agreement.

Proposal to settle obligations

15.143 In 1990, DIAND, Manitoba and Manitoba Hydro proposed a total NFA settlement to the bands. The federal government's share of this proposal was $78 million and would bring Canada's total known costs to about $195 million. The settlement offer included 206,000 acres (834 square kilometres) of provincial land to be transferred by Manitoba to Canada as new reserve land for the five bands. One band accepted this proposal; the other four did not. At the time of our audit, the matter was still under negotiation.

Community development plans

15.144 Paragraph 15.79 describes Canada's obligation to contribute to community development plans for the bands.

15.145 Canada funded community plans for all five bands. These were completed in the early 1980s. They covered a spectrum of economic and social development matters such as education, housing, transportation, health services and employment.

15.146 According to DIAND, the implementation of these plans was to be provided through its regular programs. However, there is no mechanism to monitor progress, and no reports were produced on the extent of implementation.

15.147 In 1983, the NFC filed a claim alleging that Manitoba, Manitoba Hydro and Canada failed to work towards development and implementation of comprehensive community development plans as required by the NFA. In September 1991, DIAND proposed that it would fund annual meetings of bands and federal government departments to co–ordinate planning efforts in the NFA communities. However, this funding would constitute a full and unconditional release of federal obligations for community planning. At the time of our audit, this matter was not yet resolved.

Recommendations

15.148 In making the following recommendations, we considered that the NFA is a multi–party agreement that was entered into some 15 years ago. We also considered that progress in implementing the NFA depends, to a large degree, on clarification of the responsibilities and funding obligations of all parties.

15.149 DIAND should:

(a) establish and implement procedures to encourage and monitor compliance to the NFA by all parties;

(b) ensure that a valid environmental assessment is performed to determine and report on the impact of Hydro projects;

(c) use the impact statements resulting from the environmental assessment as a basis for preparing a plan for further implementation of the NFA or assessing the adequacy of any proposed plans; and

(d) capture all NFA–associated costs, along with appropriate performance information, such as NFA impacts, achievements, claim settlements, and the nature and cost of work still to be done, and disclose this information in DIAND's annual Report.

Before entering into a future agreement of this nature, DIAND should:

(e) ensure that the agreement clearly defines the nature and extent of all financial and other obligations of each party; and

(f) obtain agreement from all parties on implementation matters such as progress target dates, priorities, monitoring procedures and methods for evaluating the adequacy of implementation.

Conclusion

15.150 Implementation of the NFA has been and remains difficult, partly because of the nature of the Agreement and the number of parties involved. Many disputes involving allegations of non–compliance with the Agreement still linger among the participants.

15.151 However, we believe there is room for improvement in how DIAND manages its responsibilities under the NFA. In view of the Department's legislated mandate for matters respecting Indian peoples, there is an opportunity and a need for DIAND to exercise greater initiative and leadership in resolving NFA issues. It is not sufficient, in our opinion, for DIAND to merely react to problems after the fact, which is the primary approach it has used over the years.

15.152 In addition, there are lessons to be learned from the NFA respecting any future agreements involving the use of natural resources that can affect Indian reserve land. DIAND should consider placing greater importance, in such agreements, upon clear responsibilities and funding obligations to each party. Further, co–ordinated plans to facilitate and monitor implementation must be prepared and agreed to by all parties.

Department's response: *DIAND agrees with the facts and observations relating to the Manitoba Northern Flood Agreement. As noted in the Auditor General's conclusion, implementation of the NFA has been difficult, partly because of the nature of the Agreement and the number of parties involved.*

With respect to the recommendations, the Department has the following comments:

(a) DIAND acknowledges that compliance with the NFA by all parties is important. Therefore, DIAND will implement procedures to better encourage and monitor compliance, with the co–operation of the other parties.

(b) and (c)

When the NFA was struck in 1977, environmental matters were generally not the priority that they are today. Over the years, DIAND and other federal departments participated in various studies or data research regarding NFA environmental impacts. For example, the Federal Ecological Monitoring Program (FEMP) studies water quantity and quality, sediment, mercury levels, aquatic life and other related matters. However, DIAND agrees that the results of these efforts cannot be considered a comprehensive environmental impact assessment.

Accordingly, DIAND will consolidate and analyze the existing information to determine what additional work is needed to complete the necessary impact statements. DIAND will encourage the other parties to participate in this process so that, together, we can plan and implement appropriate further action towards a complete environmental assessment and related remedial measures. DIAND believes that the final FEMP Report, released in April 1992, together with other DIAND initiatives, will contribute to the development of a plan for further implementation of the NFA.

(d) DIAND will improve its procedures to ensure that it adequately captures and reports the applicable information, including costs of proposed settlements.

(e) and (f)

DIAND recognizes the need to better address such things as clarity of obligations and implementation matters in future agreements of this type. This is why, with respect to the NFA itself, the Department has developed a proposed basis for settlement (PBS) that would clarify for each band how the NFA will be implemented in its own case. The recent Split Lake Cree Settlement Agreement demonstrates the ongoing efforts of the Department to remedy the difficulties in implementing the NFA.

Chapter 16

Department of National Defence

Major Capital Projects
Industrial Development Initiatives

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16.1 Major Crown Projects in DND With Current Industrial Benefit Commitments
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Major Capital Projects Industrial Development Initiatives

Main Points

16.1 Value for money in major capital projects has three major objectives: the first and pre–eminent objective is meeting operational requirements in the most cost–effective manner; the second is achieving cost–effective, long–term industrial and regional development; and the third is achieving other national objectives. This chapter addresses the interplay between the first two of these.

16.2 Prior to 1985, it was common to seek offsets in major defence procurements. In 1985, a Ministerial Task Force concluded that offsets were costly and that expectations for incremental economic activity in Canada were overstated. The report called for a reassessment of government policies in order to place more emphasis on achieving benefits of lasting value and abandoning offset maximization. This resulted in greater emphasis being placed on achieving direct benefits.

16.3 Direct participation by Canadian industry in major capital projects may involve little or no additional cost in those areas where it is already competitive. In many cases, however, Canadian participation requires investments in such areas as design, infrastructure and labour force development that will increase costs to Canada compared to the costs when dealing with established foreign suppliers. Totally unique requirements, whether sourced in Canada or offshore, would require some form of investment.

16.4 We examined six DND major Crown projects (major capital projects costing over $100 million) under contract at the start of our audit to which industrial development initiatives had been attached, in whole or in part, under the current government policy. We found that the costs associated with these initiatives were significant and that generally they have not resulted in new industrial activity that is sustainable and competitive in domestic and world marketplaces, as required by current government policy. We also found instances where DND's operational requirements have been affected.

16.5 We recommended that steps be taken to improve strategic planning in this area; to provide decision–makers with adequate analyses of costs and benefits associated with industrial development initiatives; and to improve reporting to Parliament.

Introduction

16.6 Our Report contains two chapters that deal with major capital projects in the Department of National Defence (DND). This chapter focusses on the external factors affecting these projects — the value–for–money impacts of industrial development initiatives that were attached to DND projects at the beginning of their life cycle.

16.7 The next chapter focusses on project initiation and implementation processes within DND according to three lines of enquiry: program management, project management and feedback processes.

16.8 To fulfil its roles and carry out its tasks, DND operates a wide variety of sophisticated weapon systems involving large fleets of vehicles, ships and aircraft. Although the funding available to DND to buy the equipment it needs is limited, DND has the largest capital program of all government departments.

16.9 At the time of our audit, there were approximately 550 major capital projects in the 15–year plan of the Defence Services Program with a total cost of $63 billion in 1990 constant dollars. Industrial development initiatives are usually attached to major capital projects costing over $100 million, a category called major Crown projects. There are about 70 of these major Crown projects in the Defence Services Program. DND is responsible for the majority of federal major Crown projects potentially subject to industrial development initiatives. If current trends continue, there could be as much as $30 billion in industrial development initiatives attached to DND projects.

16.10 The life cycle of major capital projects consists of four phases: initiation, implementation, in–service, and disposal. For most of the larger projects, the complete life cycle is usually more than 20 or 30 years. The initiation phase can be critical in obtaining value for money. During this phase, the need for the project is established, the procurement and industrial development strategies are set, proposals from contractors are sought, contracts are signed and project management processes are established. If things go wrong at this stage, the repercussions are likely to affect the project throughout its entire life cycle.

16.11 Procedures for implementing the government's procurement policy involve several departments. Essentially, DND establishes the need for the project, provides the operational and technical specifications and sets funding and scheduling priorities. The Treasury Board Secretariat provides general policies and guidelines for all aspects of procurement. The Department of Supply and Services assists in developing a procurement and contracting strategy and is responsible for managing the contracting process. The Department of Industry, Science and Technology, the Atlantic Canada Opportunities Agency, the Department of Western Economic Diversification and the Federal Office of Regional Development (Quebec) are responsible for industrial and regional development initiatives to be attached to major capital projects.

16.12 As soon as a large DND capital project is identified as an operational requirement for inclusion in the Defence Services Program, these departments begin to influence the procurement strategy. By the time the project has progressed through DND's Defence Program Management System to the point where Treasury Board approval (and Cabinet approval where necessary) is being sought, the procurement strategy and the bidding and contract adjudication processes have generally been agreed to by departments and industrial development initiatives have already had a major impact on the procurement strategy. The initiatives may also have affected

Industrial development initiatives attached to major capital projects at the beginning of the project initiation process have a major impact on the procurement strategy and are an important element in the achievement of value for money for DND and the Crown.

Our 1984 and 1987 reports noted deficiencies in the implementation of industrial development initiatives attached to DND projects.

the overall cost and scheduling of the project.

Audit Scope

16.13 We examined the six DND major Crown projects under contract at the start of our audit to which industrial development initiatives had been attached, in whole or in part, under the current government policy. These projects have a total cost of $11.4 billion (budget–year dollars), distributed as shown in Exhibit 16.1. In addition to the prime contract, the project cost includes such things as government project management, spare parts, facilities and training costs. Industrial development initiatives are normally attached only to the prime contract. As can be seen in Exhibit 16.1, the estimated value of the industrial development initiatives attached to these projects amounts to $6.0 billion, 85 percent of the total cost of the prime contracts.

16.14 The primary focus of our overall audit was on the extent to which value for money was achieved in procurement. In this part of our audit, we examined the approach adopted by federal departments and agencies to implement the government policy concerning industrial development initiatives attached to DND major capital projects. We examined each of the six projects from the standpoint of procurement strategy, industrial development initiatives and the bidding and bid assessment processes as they affected DND. We did not conduct audits of industrial or regional development programs of other government departments, but kept our focus on the effects of industrial development initiatives on DND projects. We examined the industrial benefits expected or actually achieved in relation to the costs. We also conducted interviews with chief executive officers and other senior executives of 28 Canadian defence contractors to obtain their perspective on the manner in which these initiatives are currently being pursued.

Exhibit 16.1

Major Crown Projects in DND
With Current Industrial Benefit Commitments
($ Millions)

Project Name	Total Prime Contract Cost [1,3]	Total Estimated Project Cost [2]	Total Value of Industrial and Regional Development Commitments [3]
Heavy Logistics Vehicle Wheeled	$ 278.1	$ 382.6	$ 324.3
Militia Light Armoured Vehicle	100.6	161.0	100.6
Arctic and Maritime Surveillance Aircraft	163.3	257.1	126.1
CF–5 Avionics Update	70.7	113.4	34.0[4]
Canadian Patrol Frigate (12 ships)	5,734.1	9,329.6	4,572.6
Low Level Air Defence	721.0	1,126.4	893.4
	$ 7,067.8	$ 11,370.1	$ 6,051.0

1 This cost includes only the amount of the prime contract with the manufacturer.

2 This total project cost, expressed in budget–year dollars, includes the prime contract plus the costs of training, facilities, spare parts and the DND Project Management Office.

3 In 1990 constant dollars.

4 Not to be reported in future Part III of the Estimates (see paragraph 16.52).

Previous Audits

16.15 Major capital projects in DND have been the subject of comprehensive audit three times in the past 12 years. In 1980, we conducted a government–wide audit of materiel management, including selected DND projects. In 1984, we examined seven DND major capital projects then in progress from the standpoint of the initiation and implementation phases of the project life cycle. We also reviewed the management of industrial offsets in the contract for the CF–18 fighter aircraft.

16.16 Our report on industrial development initiatives in 1984 included concerns about overlap in departmental roles and responsibilities and the lack of clearly defined objectives, policies and plans in the management of industrial offsets. We also noted that non–military objectives, including industrial benefits, complicated and constrained DND equipment projects. In 1985, the Standing Committee on

Public Accounts recommended that non–military objectives be identified in Part III of the Estimates and that their attainment be monitored and reported. In 1987, we noted that the recommendation concerning reporting to Parliament had been implemented, but the costs of achieving industrial benefits were not being reported.

16.17 Our 1987 Report included concerns about the need to define "Buy Canadian" goals and objectives and to specify the premium that would be paid to purchase from Canadian rather than foreign suppliers. These concerns with non–military objectives extended beyond just identifying and reporting them. It also included their cost, their impact on project objectives and the consistency of their application in the competitive process. We noted that, to a great degree, these non–military objectives were directed towards satisfying the objectives of other departments, such as the Department of Regional Industrial Expansion, but their costs were charged against DND's budget. We recommended that, where it is reasonable to do so, the direct and indirect costs associated with achieving non–military and strategic sourcing objectives should be reported in Part III of the Estimates.

16.18 In 1987, we also noted that four of the contracts we reviewed involved sole–sourcing to a Canadian supplier, thus by–passing the competitive process and specific Treasury Board contract regulations. We requested analyses to support the decision to sole–source, but the information we were given did not include any cost–benefit, economic or financial analyses to support the decision. We recommended that decisions to by–pass the competitive process be supported by a full justification in the contract file that would specify the costs, benefits and risks of doing so in comparison to the national benefits expected.

16.19 In addition to these three audits of DND projects, in our 1991 audit of the Department of Supply and Services, we reviewed management practices relating to the use of procurement in major Crown projects as an instrument for achieving industrial and regional development and other related government objectives. The focus of the audit was primarily on non–DND projects. We recommended that the Department of Industry, Science and Technology should, within its mandate, evaluate the effectiveness of the application of its policies and practices in achieving industrial development through procurement. Industry, Science and Technology agreed with our recommendation.

In 1985, the Nielsen Task Force criticized the "offsets" approach to industrial development in major Crown projects and called for a reassessment of government policies.

Background

Prior to 1986, Offsets Were Expected from Defence Acquisitions

16.20 Canada became a major manufacturer of defence equipment during World War II. Over the past two or three decades, however, defence–related production has formed a relatively small percentage of domestic industrial output. Today, Canada tends to import larger defence systems primarily from the United States, whereas the bulk of Canadian defence–related exports are parts and sub–systems destined for inclusion in U.S. system assemblies.

16.21 The Defence Production Sharing agreement and the Defence Development Sharing agreement with the United States were concluded about 30 years ago, in part to compensate Canadian industry for large military contracts going to U.S. manufacturers. In 1963, the Defence Production Sharing Agreement was amended to include a provision for a rough balance of trade over the longer term.

16.22 In addition to funding from the federal departments responsible for industrial and regional development and other forms of federal assistance, Canadian defence manufacturers are often granted provincial and municipal assistance of one kind or another. In 1959, Canada created the Defence Industry Productivity Program (DIPP) to provide cost–shared repayable contributions to foster, among other things, the continuity of research and development in Canada's defence industry. DIPP funding to Canadian manufacturers of defence equipment between 1979 and 1990 amounted to $1.8 billion.

16.23 Between 1976 and 1986, it became commonplace to seek "offsets" (now called "indirect benefits") in major defence procurements from foreign manufacturers, although often there were also some direct industrial benefits claimed in these contracts. An "offset" involved the purchase of Canadian manufactured goods and services, an investment or a technology transfer that was unrelated to the actual product being purchased by the government. The contractor was expected to deliver the equipment specified in the contract at the stated price and, at the same time, to undertake procurement, investment or technology transfer in Canada to an estimated value that often equalled or exceeded the total cost of the contract.

16.24 The results of one study commissioned by the government indicated that, during this period, Canada developed administrative policies and processes for these offsets programs that were much more complex and expensive than those in other developed countries, for example, Belgium, Denmark, Australia, the United Kingdom, the Netherlands and Sweden. United States government policy states that federal funds are not to be used to finance offsets. The U.S. also views certain offsets for military exports as economically inefficient and market–distorting.

16.25 In 1985, the Ministerial Task Force on Program Review Concerning Government Procurement (the Nielsen Task Force) reported that no one associated with the procurement process seemed to have a clear idea what industrial benefits the government was trying to achieve. It felt that the problem was not a lack of objectives but a multiplicity of overlapping, competing objectives that conveyed confusing signals to both government and industry. The report stated that the government's expectations had tended to be unrealistic and misdirected and that, in some cases, there had been gross overstatements of expectations of what would ultimately be achieved by these procurements in terms of incremental economic activity in Canada. There was growing dissatisfaction among departments, particularly DND and the Department of Transport, that their operational needs were being jeopardized by ad hoc, third–party decisions of other departments. According to the Task Force, regional distribution, technology transfer and investment benefits had been much lower than expected. Moreover, the Task Force was concerned that existing policies may have been inadvertently signalling that short–term benefits were preferred over long–term, lasting benefits.

16.26 The report called for a reassessment of government policies on the basis of certain considerations, including the following. The government's expectations of securing 100 percent offsets had been unrealistic. The benefits acquired had been much lower than expected and had mostly been of short–term value to Canada. The costs of achieving industrial benefits had been substantial. The emphasis on offsets had become a trade irritant with the United States and Europe while producing marginal long–term benefit to Canada.

The 1986 government procurement policy and subsequent policy statements stress the pre–eminence of value for money in the fulfilment of operational requirements. Industrial development initiatives, a secondary objective, are to be long–term, sustainable and cost–effective and should result in products that are internationally competitive.

Criticisms of Offsets Led to a New Policy in 1986 and an Emphasis on Direct Benefits

16.27 One result of the Nielsen Task Force report was a major shift in the industrial development policy that the government first announced in 1986. This and subsequent policy statements stressed the importance of achieving benefits of lasting value, the abandonment of offset–maximizing objectives generally and the need to use industrial development initiatives to make Canadian firms more competitive.

16.28 This new government policy makes it clear that federal objectives in procurement start with the pre–eminence of best value for money in the fulfilment of operational requirements. Essentially, this means obtaining the equipment that meets the operational requirements in the most cost–effective manner.

16.29 Secondary to this objective is the need to review procurements from the standpoint of long–term industrial and regional development opportunities, emphasizing benefits of lasting value that assist Canadian firms to become competitive in domestic and world marketplaces.

16.30 Where promising procurement strategies are identified that conflict with the concept of best value for money in the fulfilment of operational requirements, but at the same time are considered to be cost–effective from an industrial and regional development standpoint, these strategies are to be developed as sourcing options for the review of ministers prior to issuing requests for proposal to private sector contractors. Costs are to be estimated when possible, and the submissions to ministers are to include a source of funds where significant cost premiums are anticipated.

16.31 Where industrial and regional development opportunities have been included in a major capital project, the increased costs due to the industrial development initiative are to be shared between the project–sponsoring department and the department responsible for industrial development, but with the latter playing a significantly larger role in supporting those industrial benefit activities not directly associated with the project–sponsoring department's overall mandate. For DND major capital projects, DND is to fund any requirements considered essential to national security (for example, those related to creating and maintaining a defence industrial base). The costs of any industrial development initiatives not considered essential to national security are to be shared by DND and the departments responsible for industrial and regional development, with the latter providing a significantly larger share.

Procurement is not intended to be an instrument for sustaining government suppliers. Proposals for industrial development are to be analyzed and costed. Options are to be presented to ministers prior to issuing tender documents.

16.32 Where there are incremental costs involved in achieving a specific benefit, it must be demonstrated that the activity generated by the procurement is sustainable and has a clear prospect of becoming commercially viable; that the socio–economic benefits are sufficient to justify the extra cost of the procurement; and that the benefits would not be forthcoming in the absence of government assistance.

As in any other form of investment, the anticipated returns from investment in industrial development are to be compared against the costs.

16.33 The new policy has been interpreted by officials as emphasizing the need to seek cost–effective, direct industrial benefits related to the actual system or product being purchased by the government. Although indirect benefits unrelated to the actual system or product being purchased (previously called "offsets") can still be proposed, the primary effort is to be focussed on direct benefits. Both direct and indirect benefits could include "production effort", or the Canadian content value of goods and services; technology transfer that is exploitable in terms of access to world markets; and investments that result in sustainable industrial and regional development.

Observations

The private sector firms involved in these projects have no choice but to conform to the procurement approach.

Direct participation can increase costs and risks

16.34 Under the offsets approach before 1986, foreign bidders knew that the size of the dollar value of the offsets in their proposals would be considered as part of the assessment and would, therefore, have a major impact on the selection of the winning bidder. Since offsets are not directly related to the product being acquired, and most weapon systems were manufactured and assembled abroad, this approach did not require bidders to alter production processes. The risk to the Crown, therefore, was related primarily to the delivery of the anticipated benefits. There was less risk that the cost of providing these offsets would increase the cost of the product being delivered.

16.35 The new government policy lays out a framework for achieving value for money in meeting operational requirements, while at the same time seeking industrial development opportunities that are long–term and sustainable and result in products that are competitive in domestic and foreign markets. While this new policy has the potential to produce high–quality initiatives of great value to Canada, it also poses a significant implementation challenge for government officials.

16.36 The procurement approach that is being used to implement the new policy, however, is much the same as the approach prior to 1986. Most of the burden of identifying and proposing specific industrial and regional development initiatives in major Crown projects continues to be placed on the shoulders of the private sector, rather than residing in the federal departments responsible for industrial development initiatives. This is achieved by including the requirement that bidders propose industrial and regional benefits in requests for proposal, along with price and technical suitability in meeting operational requirements.

16.37 The approach also continues to be structured to reward the firms whose proposals maximize industrial benefits. Today, the emphasis on direct benefits means that foreign firms, which are often the only ones with the manufacturing capability for large military equipment, but whose facilities are not normally located in Canada, may be precluded from supplying complete weapon systems or from bidding directly.

16.38 A variety of approaches has been used to achieve greater direct participation by Canadian industry. In some cases, Canadian companies are set up as prime contractors to complete the final assembly of equipment designed and manufactured abroad. Canadian firms are also being set up to integrate these weapon systems. As well, offers are made to use as many components from Canadian sources as possible. While Canada has areas of industrial strength, the components supplied by Canadian firms for the projects we examined were often of relatively low technology. They may or may not have been price–competitive with similar components available on the international market and often required considerable additional design and testing to integrate them successfully into the original product.

16.39 Successful foreign manufacturers of major defence systems already have complete production processes. They often have amortized the costs of investment, design, project management and start–up over large production runs and may also have achieved economies of scale. This makes for a highly competitive marketplace. Where a contract for manufacture or final assembly is awarded to a company, whether in Canada or elsewhere, that has never designed and manufactured high technology defence systems or products, there are bound to be higher costs and greater risks.

16.40 Firms doing business with government have no choice but to conform to the procurement approach defined by the terms and conditions of the request for proposal. To do otherwise would ensure that their bids would be unsuccessful.

16.41 Exhibit 16.2 is a conceptual diagram that portrays the fundamental issue in government procurement policy in the area of industrial development initiatives attached to major capital projects. Any cost to the Crown and industry of undertaking an industrial development initiative must be more than offset by the returns on this investment in the form of enhanced productivity that enables goods to become internationally competitive. The value of this enhanced productivity can be estimated by the expected profits from future international and domestic sales over some reasonable horizon. The same principles would apply to any country engaging in industrial development of this type.

16.42 In areas where Canadian firms are already competitive, there may be little or no additional costs associated with their involvement in a project. Also, if a defence requirement is so unique that no other comparable product can be provided by a foreign firm, it may be just as cost–effective to build it in Canada. In most cases, however, direct Canadian participation would require investment in such areas as product design, infrastructure establishment or labour force development. When a decision is taken to make investments of this type, analysis should be carried out to ensure either that the short–term and long–term benefits justify the investment, or that any unique capabilities are cost–justified.

16.43 Estimating these costs and returns would be quite simple in some cases and considerably more complex in others, particularly where the operational requirements include certain unique capabilities for meeting Canada's special military needs that would have to be weighed against the cost of meeting them. In complex programs it may be difficult to obtain precise selling prices from alternative manufacturers, and future estimates of sales and potential market share may be subject to varying degrees of certainty. Nevertheless, government policy requires analyses of the costs and the future returns. Judgment will have to be exercised as to the level of resources needed for these analyses to provide a reasonable assurance of value for money. We realize that this work can be difficult in the more complex procurements, but we believe that it can and must be done.

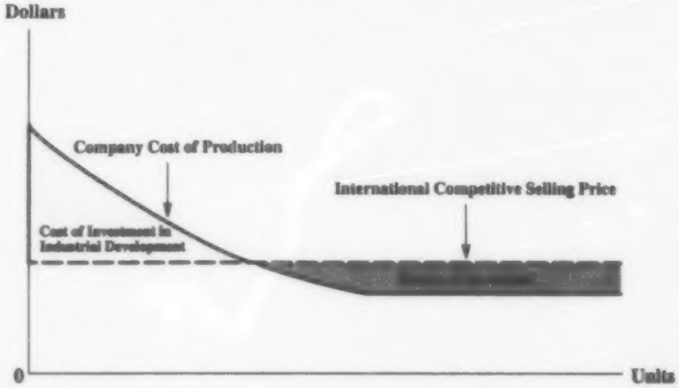
Our Review of Six Projects Demonstrates Some of the Problems That Can Be Encountered

16.44 The six projects that we examined can be grouped into three types. Two of the projects — the Militia Light Armoured Vehicle and the CF–5 Avionics Upgrade — are examples of situations where industrial or regional considerations caused the normal procurement process to be by–passed. Three of the projects — the Low Level

Overall, our audit found that there could be a significant cost to pursuing industrial development initiatives, that few long–term benefits have resulted and that, in some cases, DND's operational requirements have been affected.

Exhibit 16.2

Value for Money in Industrial Development



The returns on investment must be greater than the costs of investment.

Air Defence, the Canadian Patrol Frigate and the Heavy Logistics Vehicle Wheeled — are examples of projects where it was decided that Canadian industry would play an important role in the design, manufacture, assembly or integration of equipment not previously built in Canada. The Arctic and Maritime Surveillance Aircraft project is largely an off–the–shelf acquisition, with some Canadian industrial participation.

Two projects were influenced by industrial or regional priorities

16.45 The Militia Light Armoured Vehicle (MILLAV) project. In 1976, the Diesel Division of General Motors (DDGM) in London, Ontario, adapted a Swiss–designed light armoured vehicle (LAV) for manufacture in Canada. DDGM pays MOWAG of Switzerland licence fees for manufacturing the LAV in Canada.

16.46 In August 1988, DDGM submitted an unsolicited proposal to the Minister of National Defence to build 200 LAVs for the Canadian Militia. The proposal stated that, due to a production gap following their order for 759 LAVs for the U.S. Marines, there was a serious danger that their defence operations could be closed by their parent corporation, which would result in the loss of 375 jobs in the London area. They also indicated that their future looked bright with a strong possibility of export sales of thousands of vehicles.

Light armoured personnel carrier. One hundred and ninety–nine of these are being built as part of the Militia Light Armoured Vehicle (MILLAV) project (see paragraphs 16.45 to 16.48).

16.47 The procurement approach that was originally being adopted to meet DND's operational requirement was to acquire tracked vehicles, which would be compatible with the equipment used by the Regular Force units with which the Militia was expected to serve. Concern was expressed that the MILLAVs had limited ability in rough terrain or deep snow and that differences in training approaches would affect operational effectiveness. As well, the MILLAVs were more expensive initially than the tracked vehicles, and the process of introducing them quickly into DND operations resulted in disruptions in maintenance and training. These initial costs may be offset against the increased cost of operating tracked vehicles depending on usage rates. In October 1988, however, the Minister of DND, with the support of the Chief of the Defence Staff, responded that he would seek the support of his colleagues for the purchase of the GM vehicles.

16.48 The industrial benefits commitments in the contract amounted to $91.5 million, the exact amount of the prime contract. Sixty percent of this represents the Canadian content of the vehicle. The rest is offsets in the form of acquisition of other Canadian products by GM. Company officials advise us that the offsets commitments will be exceeded by over 200 percent.

16.49 The CF–5 Avionics Upgrade project. Canadair Ltd. of Montreal, Quebec, produced the CF–5 fleet in the late 1960s. In 1984, DND recommended that the aircraft have an avionics upgrade to replace unsupportable avionics and to make it a more suitable transition trainer for the highly sophisticated CF–18 aircraft.

16.50 In 1986, a consortium including Bristol Aerospace of Winnipeg was found to have the best overall bid for the systems engineering support and airframe repair and overhaul contract for the CF–18. As events unfolded, however, the contract was awarded to Canadair, the leader of the consortium that had ranked second, since it was judged that downstream technology transfer could be better done through Canadair.

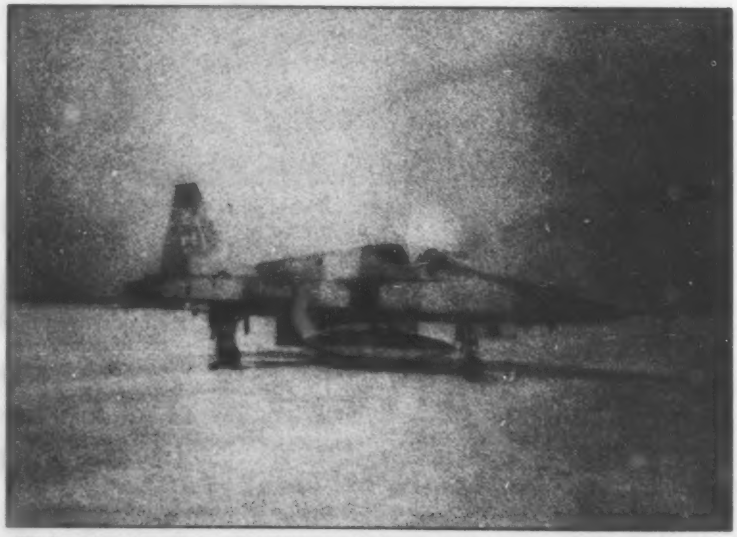
16.51 In January 1987, one month after the signing of the CF–18 contract, it was announced that industrial support activities for the CF–5 would be transferred from Canadair to Bristol, to achieve a more equitable distribution of aerospace procurement. This decision resulted in additional costs to the Crown because of the transfer of tools and technical documentation to Bristol; additional contract costs for the prototype and production contracts; delays and the learning curve at Bristol; loss of efficiency because other repair work could not be done at the same time as this upgrade work, as originally planned; and additional government assistance in support of international marketing studies and prepositioning investments.

16.52 There are no contractual commitments for industrial benefits associated with this project. Nevertheless, the 1992–93 Part III of the Estimates reports $34 million of production effort, offsets and technology transfer. These costs had been identified prior to the decision to sole–source the contract to Bristol, when it was assumed that the Crown would acquire major components of the upgrade and provide them to the contractor as government–furnished equipment. As a result of our audit, Industry, Science and Technology officials have advised DND that no further reporting of industrial benefits against this project need be made in Part III of the Estimates.

Three projects were structured to have Canadian industry play a lead role

16.53 The Heavy Logistics Vehicle Wheeled (HLVW), Low Level Air Defence (LLAD) and Canadian Patrol Frigate (CPF) projects are examples of decisions to have Canadian industry play a lead role in a major Crown project. In the case of CPF and HLVW, bidding was restricted to Canadian companies, whereas in LLAD the decision resulted from the acceptance of the successful bid from an international competition. All three contracts were awarded to the lowest bidder, within the constraints imposed on the contractual process. In all three cases, the equipment being acquired had not previously been built or assembled in Canada.

16.54 In the case of the HLVW, UTDC Inc. of Kingston, Ontario, assembled trucks using components provided by Steyr of Austria for the major elements such as the engines, transmissions and axles, as well as other components and assemblies that were to be provided by Canadian manufacturers and suppliers. This included items such as cargo boxes and



CF–5 Fighter Aircraft. The CF–5 Avionics Update project involves upgrading 44 of these aircraft (see paragraphs 16.49 to 16.52).

handling equipment, as well as a range of lower technology items. Some of these were licensed from foreign firms, and some others involved primarily the assembly of components supplied by foreign firms. Component suppliers had to design their products and then put in place the necessary production processes. UTDC's overall responsibilities involved ensuring compatibility between the various components, assembly, systems integration and project management.

16.55 In the case of LLAD, Oerlikon Aerospace Inc. of St. Jean, Quebec, was responsible for the assembly of the major components of the Air Defence Anti–Tank System (ADATS), part of the LLAD system, and systems integration of the entire LLAD system. A few of the elements of the ADATS, such as the radar, are being supplied by Canadian firms under licence from foreign firms.

16.56 In the CPF case, Saint John Shipbuilding Limited of Saint John, New Brunswick, assumed responsibility for the design, hull construction and assembly of state–of–the–art frigates. Paramax of Montreal, Quebec, a major sub–contractor to Saint John Shipbuilding, is designing a systems integration package that is viewed as being at the leading edge of technology.

Ten–tonne heavy logistics vehicle. About 1,200 of these in various configurations have been built for the Heavy Logistics Vehicle Wheeled (HLVW) project (see paragraphs 16.53 to 16.54).

16.57 Each of these three projects involved a substantial investment by the firms and by the Crown to bring them to their current state. This included the need to either substantially upgrade or establish the necessary plant or equipment, hire and train a skilled labour force, undertake necessary design, develop a systems integration package, and manage the project. As well, federal government project management costs are greater for these complex developmental projects than is normally the case for off–the–shelf buys. In all three cases it was concluded that unique Canadian operational requirements precluded an off–the–shelf acquisition from foreign suppliers, although in the HLVW and CPF cases there were similar weapon systems in production or being designed at the time the decisions were taken.

16.58 As Exhibit 16.2 indicates, investments for industrial development are recovered through the profits from future sales. The companies involved in these three projects have been marketing their products internationally but, with a few exceptions, have not yet been successful for a variety of reasons. The international market for defence equipment is very competitive, export restrictions limit the markets to which certain Canadian defence products can be sold, and larger industrialized nations usually prefer to build their own systems. Canada's domestic market is small, and the changing international situation has created further pressures on the defence acquisition budget.

16.59 While there are advantages to Canada from building systems here rather than buying them from foreign suppliers — reduced unemployment and increased utilization of industrial capacity — there is considerable debate about the significance of these benefits and how they should be valued in cost–benefit analyses. Treasury Board and Industry, Science and Technology cost–benefit manual guidelines indicate that while these benefits might accrue to a particular region or industry, they can be offset by equal or greater disadvantages to other regions or industries.

One project was an off–the–shelf procurement

16.60 The Arctic and Maritime Surveillance Aircraft (AMSA) project. This acquisition was handled essentially as an off–the–shelf purchase.

16.61 Canadian participation in the project consisted of supplying about $4.5 million (U.S.) of components normally supplied by Canadian firms to Lockheed U.S. for this type of aircraft. Another $12 million (U.S.) is work undertaken in Atlantic Canada to install components needed to meet DND's operational requirements. We were informed by officials at Lockheed that this work did not entail any greater costs than it would have if done by Lockheed at its U.S. plant.

16.62 Offsets amounting to $90 million (U.S.) were committed: $40 million (U.S.) in the form of purchases from Western Canada and the Atlantic provinces; and $50 million (U.S.) in the form of the possible supply of Canadian components for the planned U.S. Navy acquisition of the P–7 anti–submarine warfare aircraft. The P–7 project has now been cancelled, and company officials advise us that they are trying to find alternatives to meet these commitments.

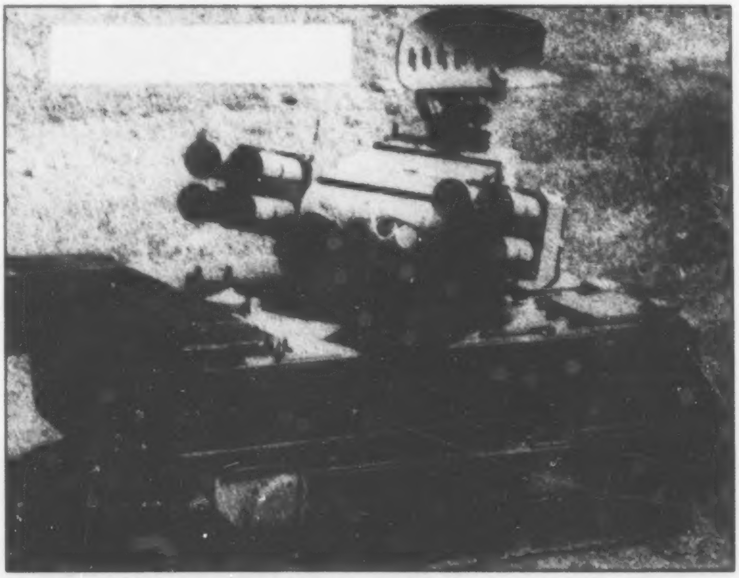
General Observations Resulting from Our Review of Projects

16.63 Our audit of these six projects resulted in a number of general observations that apply to most of them.

16.64 First, there was no long–term strategy regarding industrial development initiatives for any of the projects to guide the selection of an appropriate procurement approach. As we point out later, the chief executive officers of Canadian defence suppliers felt that it would be useful to begin the development of a strategy for Canadian industry participation in these projects well before the bidding process begins.

16.65 Second, none of the procurement strategies that were adopted was supported by a thorough analysis of the costs, benefits and potential risks. Alternatives, such as joint ventures with other nations, were not assessed. Where unique operational requirements were involved, no assessment was made to compare the costs involved in meeting these requirements with the cost of equipment already available or being designed.

16.66 Third, although the bids were adjudicated on the basis of price, technical suitability and industrial benefits, it was often not made clear in the request for proposal how these factors would be weighed in the final decision or what characteristics the



Air Defence Anti–Tank System (ADATS). As part of the Low Level Air Defence (LLAD) project, 36 of these are being developed (see paragraphs 16.53 to 16.55).

industrial development initiatives needed to be acceptable.

16.67 Fourth, decisions to use procurement for immediate national or regional needs, to produce in Canada a unique operational capability, or to Canadianize components can involve substantial costs. In the cases we looked at, these costs ranged from the costs of simply administering industrial benefits for off–the–shelf procurements to up to 20 percent of the total project costs. When viewed over the 15–year Defence Services Program, which involves major Crown projects totalling over $50 billion, these costs could amount to several billions of dollars.

16.68 Fifth, in the cases we examined, the amount of long–term, competitive industrial activity that has resulted from the industrial development initiatives has, so far, been quite limited. A number of the sub–contractors that were chosen to produce components for the various products are now out of business. Despite strong marketing efforts by the prime contractors and major sub–contractors, few additional sales have yet been secured, although some promising prospects are being pursued.

16.69 Sixth, in some cases the pursuit of industrial development initiatives has affected the approach taken to meet DND's operational requirements and the scheduling of projects, or has affected regular operations. As well, because the additional costs of industrial development initiatives are now borne by DND, the funds available for other operational requirements are reduced. On the other hand, the desire to obtain equipment that exceeds existing or planned capabilities elsewhere in the world leads to substantial investments for the design and production of the equipment.

16.70 Seventh, the amount of validation or audit of the benefits achieved against the contractual commitments seems low.

16.71 Eighth, the information that is reported in Part III of the Estimates needs to be significantly improved. There is no indication of the costs involved for industrial development initiatives, and accountability for the expenditures is not clear. The industrial benefits that are reported in Part III of the Estimates for these projects are largely the Canadian content of certain industrial activities, which are further categorized as "direct" or "indirect". Direct Canadian content is simply the value of Canadian content in the product being bought by DND and would not be viewed as benefits in the sense expected by government policy. Indirect Canadian content reflects the value of future anticipated sales of the product being bought, or the Canadian content of other non–project related goods or services (offsets) that the prime contractor will arrange to be bought, from Canadian firms. The actual net benefit to Canada of these offsets has not been defined, and in many cases, the anticipated future sales have not materialized. To a lesser extent, the other direct and indirect benefits claimed involve the value of technology acquired and the value of

HMCS Halifax undergoing sea trials. This is the first of 12 ships being produced under the Canadian Patrol Frigate (CPF) project (see paragraphs 16.53 and 16.56).

investments made by foreign firms in Canada.

Interviews with Chief Executive Officers in Industry Reinforce the Need for Improvements

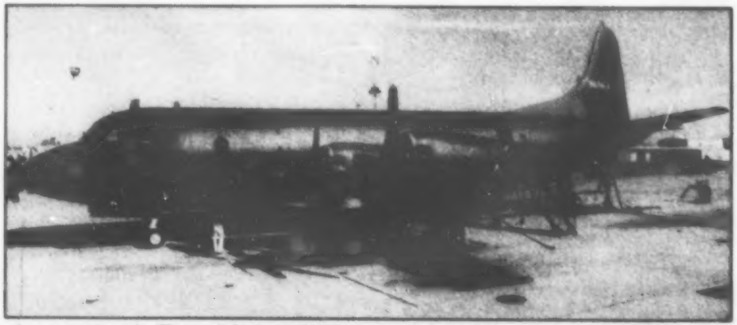
16.72 We interviewed 37 chief executive officers (CEOs) or other senior executives of 28 firms. Twenty-six of these firms are now prime contractors or major subcontractors for one or more of the active DND major Crown projects, and two others are firms whose bids on a DND major contract were not successful.

16.73 Although most CEOs believe that major Crown projects can present opportunities for industrial development, they are very concerned about the way the process is being implemented. In large measure, what the CEOs would like to see happen is exactly what is required in the government's procurement policy.

16.74 The feelings of industry leaders about industrial development are both very strong and quite consistent. Although a few of the people we interviewed were positive about their own experiences in this area, most were very critical about the current approach. A few firms told us that they have seriously considered dropping out of dealings with government to avoid the problems created by the current implementation process. Some CEOs argue that Canada would be better off if it stopped including industrial development initiatives in government procurements. Most believe that such initiatives are an inevitable part of the process, but want them to be better managed. At the very least, they would like the criteria against which these initiatives will be assessed to be clearly and completely described before the bidding process and not changed during the competition.

16.75 In our 1987 Report, we recommended that departments identify the costs associated with industrial development initiatives, where it is reasonable to do so. Responses from government officials suggested that for projects then in progress it was not possible to determine these costs. We asked CEOs whether they believed it would be possible to determine the cost of supporting industrial and regional goals. Most agreed that these costs could be determined and strongly believed that they should be. Many of them are concerned that companies are being encouraged to do things that do not make good economic sense and that there is no thorough analysis of whether or not a proposed industrial development initiative is reasonable.

16.76 Most of the CEOs felt that the current approach to these initiatives was defeating their original intent. Many believed that they actually reduced the competitiveness of Canadian companies or industry sectors. In some cases, foreign firms are encouraged to establish capacity that competes with existing firms located in Canada, some of which were encouraged by the government to be in that market area in the first place. Sometimes, staff are displaced and the original firm withdraws from the market area due to a lack of orders. In other cases, firms are required to break up efficient operations, which reduces their overall competitiveness. Some CEOs believe that firms already located in Canada are actually at a disadvantage because they



Arcturus aircraft. Three of these are being procured through the Arctic and Maritime Surveillance Aircraft (AMSA) project (see paragraphs 16.60 to 16.62).

cannot offer new investment or technology transfer. Other examples of what was often described as "policy schizophrenia" include the refusal to approve export permits for products that were developed using federal resources and the unwillingness to use products developed with federal support.

16.77 Canada's defence requirements in peacetime are usually so small that it does not make economic sense to set up a production capability to serve just this market or to expect a number of Canadian firms to compete for this market. International markets are very competitive, and countries with larger demands usually supply their own needs. This problem is growing as the demand for defence equipment drops in response to declining defence budgets around the world. In this highly competitive market, most CEOs feel that Canada needs a clear industrial strategy and a stable defence policy to guide industrial development initiatives. In the opinion of a number of CEOs, government officials need to consider entirely new approaches. One example of the kinds of things that could be considered is the possibility of concluding strategic deals between nations in which another country might supply an entire weapon system, but would agree to buy a competitive Canadian product.

16.78 CEOs identified examples of what they felt to be successful industrial development initiatives. When asked to identify the factors that made them successful, the usual responses were that the initiative did not compete with existing Canadian production effort; that it made good economic sense; and that the product was needed in Canada and competed successfully in foreign markets.

16.79 The view was often expressed that by the time a contract reaches the request for proposal stage it is really too late to generate strong industrial development initiatives. Most believe that earlier planning is needed and that mechanisms should be established to allow this to occur on a regular basis. Many suggested that industry should be involved in identifying meaningful industrial development opportunities. There is a strong view in the private sector that we need a fundamental review of how industrial development initiatives in government procurements are managed and that we should look at different approaches to gaining benefits from procurement.

16.80 In summary, the CEOs consistently suggested that there was a need for a longer–term approach to this area, better planning, and rigorous analyses of the costs and benefits of any initiatives.

Conclusions

There Is a Need to Better Manage the Relationship Between Operational Requirements and Industrial Development Objectives

16.81 Had the government procurement policy been followed more closely in the projects we audited, the primary procurement strategy would have been to start with the intention of fulfilling DND's operational requirements in the most cost–effective manner. From this basic strategy, the departments responsible for proposing industrial development initiatives would then have submitted specific proposals, based on an adequate analysis of the costs and benefits, to place Canadian industry in a position to realize long–term, sustainable benefits that would make them more competitive internationally. Where adequately justified, these proposals would have been incorporated in the procurement strategy.

16.82 The costs of any industrial development initiatives not considered essential to national security are to be shared by DND and the departments responsible for industrial and regional development, with the latter paying a significantly larger share. Both DND and the department(s) sponsoring the industrial development initiative would have obtained the funds to pay for any extra costs involved from programs clearly identified for this purpose in their respective departmental Estimates. This would have ensured that funding for industrial development initiatives would be properly approved by Parliament. Appropriate arrangements could then have been made for the proper tracking and monitoring of these initiatives. Unfortunately, this process was not followed in any of the six projects we reviewed.

16.83 The approach to industrial development initiatives used for the projects we audited was basically the same as the one used prior to the 1986 policy, even though the expectations of the policy are more demanding and present greater risks. The new emphasis on direct benefits resulted in production or assembly in Canada by firms that had never undertaken projects of this type or complexity. It continued to be clear to bidders, however, that their chances of winning a contract improved if the industrial benefits offered were maximized.

16.84 Firms were asked to identify and propose industrial development initiatives, which they would include in their bids. Any additional costs associated with the procurement strategy would be reflected in the prices they submitted. Government officials assessed these industrial development proposals from the standpoint of their likelihood of being achieved. Without information on the costs of these initiatives, and in the absence of overall objectives and strategies, they could not assess them against the objectives of the procurement policy.

16.85 This situation is carried through to existing monitoring and reporting arrangements. Monitoring and audit is done against the commitments made in the contracts, and commitments and results are reported in Part III of the Estimates. These reports give the impression of extensive industrial development occurring in Canada as a result of these procurements. In fact, the direct benefits reported are primarily the Canadian content of the products acquired, and these benefits can be seen as increasing due to things like cost overruns, inefficient production arrangements, layers of subcontractors adding costs and profits, and higher overheads. As the Nielsen Task Force reported, the benefits expected from indirect initiatives such as offsets can be unrealistic.

The problem does not lie with the government procurement policy. The current procurement approach does not contain the steps necessary to implement the policy.

16.86 None of the procurement strategies in the projects examined was officially justified by DND as essential to the development of a Canadian defence industrial base capable of sustaining an expansion of the Canadian Armed Forces, if and when needed. However, in some cases, the final documents in the procurement process indicated that the "Buy Canadian" strategy would support the development of a defence industrial base. Had this been given officially as a primary reason for favouring a Canadian supplier, it would have constituted a DND operational requirement. According to the government procurement policy, all costs, whether for the equipment or for the enhancement of the industrial base, would then have to be borne by DND. Under the government policy, industrial development initiatives attached to DND projects not related to operational requirements or the defence industrial base would be funded primarily by the sponsoring industrial development departments. Given that the Canadian Armed Forces have been operating for decades under a "forces–in–being" concept, without any plans for significant expansion, any references to a need to develop a defence industrial base for Canadian military reasons would be particularly difficult to justify.

16.87 Our audit indicates that there is a need to establish a better way to manage the relationship between operational requirements and industrial development objectives. The current process generates an adversarial posture between departments, rather than a co–operative one, and has created considerable concern in the private sector. We believe that if responsibility and accountability were clearly defined, and better processes established to discuss tradeoffs between meeting operational requirements in the most cost–effective manner and achieving cost–effective industrial development that is long–term and sustainable, greater overall value for money for the Crown could be achieved.

16.88 Near the end of our audit, in June 1992, Treasury Board approved the chapter of its Procurement and Project Management volume that deals with Procurement Review. If implemented as written, this policy should address many of our concerns.

Recommendations

16.89 The departments responsible for industrial and regional development, after consultation with the Canadian private sector, should develop overall objectives stating clearly what is expected to be achieved from industrial development initiatives and a strategy to accomplish these objectives.

Department of National Defence's response: DND fully supports the essence of this recommendation.

16.90 The Department of National Defence, in co–operation with the departments responsible for industrial and regional development, should start from the standpoint of meeting operational requirements in a cost–effective manner, regardless of where suppliers are located. Given this baseline, the departments responsible for industrial and regional development should, after consulting with the Canadian private sector, identify opportunities to take advantage of recognized competitive Canadian sources of supply or to establish new Canadian sources of supply. These should be subjected to an adequate analysis of costs, benefits and impacts on DND operational requirements and scheduling. This analysis should consider costs, if any, of developing Canadian industry to a competitive position, the risks associated with pursuing these initiatives and the benefits to be derived, especially those of a long-term and sustainable nature. The departments should then recommend cost–effective options to officials and, if necessary, to ministers, along with a source of funding, prior to issuing requests for proposal.

Department of National Defence's response: DND fully supports starting all equipment acquisition projects from the baseline of meeting operational requirements in a cost–effective manner. We also fully concur with the balance of the recommendation, that a comprehensive analysis of the costs and benefits associated with industrial development opportunities be implemented in each instance where they are being considered, and that a source of funding be identified.

16.91 Alternatives should be assessed to ensure that adequate resources are devoted to planning, analysis, validation and audit of industrial development initiatives. This could include recognizing incremental resource requirements as part of the total project costs presented to decision makers.

Department of National Defence's response: The Department agrees that adequate resources must be available to ensure that the planning, analysis, validation and audit of industrial development initiatives may be effected competently. Any incremental cost of these resources should be identified as a cost associated with industrial projects, to be funded from *the appropriation of the department sponsoring the industrial development initiative.*

16.92 To encourage accountability in the pursuit of industrial development initiatives of lasting value through DND procurements, officials should consider ways of implementing the government procurement policy requirement that any incremental costs of these initiatives be shared by DND and the departments responsible for industrial and regional development.

Department of National Defence's response: *DND would consider sharing incremental costs in those instances where they contribute to the development of strategic defence industrial base requirements.*

16.93 The departments sponsoring industrial development initiatives should adequately monitor and audit them. The costs and results of these initiatives should be fairly and accurately reported to Parliament in Part III of the Estimates, with a view toward achieving consistency in presentation over time.

Department of National Defence's response: *DND fully supports the essence of this recommendation.*

Department of Industry, Science and Technology's overall response to the recommendations: *The Department of Industry, Science and Technology agrees with the thrust of the recommendations and is undertaking a number of initiatives that will deal directly with them.*

Chapter 17

Department of National Defence

Major Capital Projects
Project Initiation and Implementation Within DND

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Department of National Defence

Major Capital Projects
Project Initiation and Implementation Within DND

Assistant Auditor General: David Rattray
Responsible Auditor: Tom Hopwood

Main Points

17.1 In the previous chapter on Major Capital Projects in the Department of National Defence (DND), we focussed on external factors at the beginning of the life cycle. In this chapter, we examine the effects of the systems, policies and procedures developed within the Department of National Defence that affect value for money in the procurement of major capital projects.

17.2 We found the Defence Planning and Force Development Process to be deficient in much the same way as its predecessor, the Policy Planning Process, which we reported in 1984. In its present form, it still does not provide an adequate basis for the unfolding of the Defence Program Management System. None of the projects we examined in our statistical sample was based on formally approved policy planning documents in the Defence Planning and Force Development process, and none had proceeded through the entire process as it is described in official DND documents.

17.3 We found the Defence Program Management System to be ineffective as well as cumbersome, and very expensive in terms of the resources devoted to it. The process simply has not been followed and did not appear to be workable in practice. These shortcomings, added to those identified in the previous chapter related to factors external to DND, have significant adverse impacts on the attainment of value for money.

17.4 Improvement of the Defence Planning and Force Development process is a prerequisite to improvement of the Defence Program Management System.

17.5 The program control process for the day–to–day management of the 550 major capital projects in the Defence Services Program is not described in the Defence Program Management System document or any other official DND document. There is no visible priority system for the entire matrix of projects and the Defence Services Program Information System, in its present form, does not provide a suitable basis for program control.

17.6 Most of the problems we observed – late delivery, cost escalation or failure to provide equipment that meets the operational requirement – were related to external and internal problems generated early in the project life cycle during project initiation.

17.7 In 1988 we reported that excessive amounts of spare parts were being procured and stocked by DND. In this audit, we found that the prices paid were also significantly higher than necessary.

In the previous chapter, we focussed on the effects of external factors during the initiation phase of the project life cycle. In this chapter, we focus on factors within the Department, starting also at the beginning of the life cycle and working down to the later stages.

Introduction

17.8 In the previous chapter, we focussed on external factors affecting DND major capital projects during the earliest stages of their life cycle. In particular, we focussed on the impact of industrial development initiatives attached to them during the initiation phase of the project life cycle. In this chapter, we examine the effects of DND's internal systems, policies and procedures designed to identify these projects, gain approval for them, and manage them until the equipment is finally delivered.

17.9 To fulfil the roles and tasks assigned by the government, DND needs to maintain its equipment and replace worn–out or obsolete items. This results in an annual expenditure on capital equipment of about $2.8 billion, or approximately 22 percent of the Department's 1992–93 budget of $12.5 billion.

17.10 The equipment involved can be complex and sophisticated, incorporating the latest technology in electronics, propulsion systems, avionics, radar, sonar and computers. To maintain the operational capability required by the government, the Defence Services Program, a 15–year capital procurement plan, included during the audit some 550 major capital projects (projects costing more than $1.0 million) with a total estimated cost of $63 billion.

Audit Scope

17.11 To audit DND internal factors, we followed the same general approach as we did for the external factors reported in the preceding chapter. We examined the effects of the overall systems and processes used to manage these projects, starting with the beginning of the life cycle and working down to the later stages.

17.12 This part of our audit also focussed on value for money in DND major capital projects. It included three lines of enquiry. Starting at the beginning of the project life cycle, the first line of enquiry was Program Management. Essentially, this involved examining the Defence Planning and Force Development process and the Defence Program Management System, the overall process that specifies how projects in DND are identified and justified until they receive Treasury Board approval, following Cabinet approval where necessary.

17.13 Our second line of enquiry, which we have called Project Management, focusses on the cost, schedule and performance aspects of the equipment ultimately delivered. In larger projects, a Project Manager is appointed and assisted by a Project Management Office, which can involve several hundred people. The third line of inquiry involves the feedback processes within and across the Defence Planning and Force Development process, the Defence Program Management System and the Project Management System. This line of enquiry is reported as an integral part of the sections in this chapter on Program and Project Management.

Observations and Recommendations

Program Management Can Be Streamlined

Managing all projects in the Capital Program

17.14 Program Management as we have defined it includes the processes and systems through which projects are identified, justified and approved. It also includes the day–to–day management of the entire matrix of 550 major capital projects in DND.

17.15 During the 1970s, DND developed a sophisticated capital project acquisition process to ensure that proposed procurements were fully justified in terms of operational necessity and government policy, and that the project initiation and implementation processes were consistent with central agency directives. At the time, DND was in the forefront of the federal public service in codifying procedures to identify and implement major capital projects within an overall program planning process.

The Defence Planning and Force Development process and the Defence Program Management System form a hierarchical, sequential process in which broad statements of government policy are gradually transformed into increasingly more specific statements of what is needed to fulfil that policy.

17.16 The Defence Planning and Force Development (DPFD) process. The purpose of the DPFD process is to transform the roles, missions and tasks of government defence policy into a required military force structure of personnel and equipment. This required structure is then compared with the existing structure to determine the deficiencies that will need to be addressed if the Forces are to have the capability to perform the missions and tasks assigned to them. The process is a complicated one that also includes strategic assessments, threat assessments and political and budgetary inputs. From the standpoint of major capital projects, the output of this process is the identification of capability deficiencies that can be rectified, in whole or in part, by acquiring capital equipment. It is at this point that the Defence Program Management System takes over and, through a series of documents, progressively refines the broad statements of deficiency identified during the DPFD process until the optimum type and quantity of equipment is defined and Treasury Board or Cabinet gives project approval.

17.17 The Defence Program Management System (DPMS). The DPMS was originally designed as a capital equipment acquisition process. In theory it has been adapted to cover all DND resource allocation. In practice, however, its primary use has remained essentially the same as the one for which it was originally designed. With the passage of time, it has become increasingly apparent that it has been unnecessarily complex, process driven, costly and not entirely appropriate for the management of a defence capital program.

17.18 At the end of the Defence Planning and Force Development process, the Defence Program Management System commences when a document called a Statement of Capability Deficiency is raised and circulated for approval.

17.19 Following departmental agreement that a deficiency as described does exist, work commences on a second document called a Program Planning Proposal (PPP) designed to identify broad solutions in terms of equipment, personnel and infrastructure. At this stage, costs are identified only in rough orders of magnitude. Once again, the document is circulated for comment, amendment and approval.

17.20 After it has been approved, work commences on a document called the Program Development Proposal (PDP) in which options and impact analyses are conducted on the options identified in the Program Planning Proposal. At this stage it is expected that departmental and Treasury Board approvals–in–principle will be sought. The PDP is circulated for comment, amendment and, ultimately, approval.

17.21 Following the necessary approvals for the Program Development Proposal stage, work commences to produce a Program Change Proposal (PCP) document in which the proposed solution (equipment to be procured) is defined in detail along with the best available cost data and a specific schedule for procurement. This document is circulated for comment, amendment and approval. Once departmental approval has been obtained, a Treasury Board Submission is raised to seek Effective Project Approval.

17.22 Once Effective Project Approval has been obtained from the Treasury Board, following Cabinet approval where necessary, Requests for Proposal can be issued to qualified contractors, either to procure equipment off the shelf or to have the equipment custom made.

17.23 At the earliest stages of the Defence Program Management System, broad options are considered. For example, the provision of supplies to front–line troops might be achieved by truck, tracked vehicle, helicopters, aircraft or some mixture of these. Once the appropriate option is selected, it is then possible to assess the different types and numbers of vehicles or aircraft that best meet the requirements. The process continues until vehicles with specific operational and technical qualifications have been identified. At that point, it is possible to obtain refined cost and delivery schedules and issue a Request for Proposal to qualified contractors.

17.24 Although in practice there may be some opportunities to commence work on succeeding documents in the hierarchy before the preceding documents have been approved, in theory each step is sequential, because the work involved in any one step depends on the options and decisions taken at the conclusion of the preceding step. In theory also, the precise nature, type and quantity of equipment needed is not clear until the process is complete. At that time, all of the possible options have been assessed progressively until, following the evaluation of the various contractors' proposals, the best equipment for the job at the lowest price is purchased. In theory, if the entire process is followed, the equipment finally procured should be the least costly and the best suited to fulfil the operational requirement. It should also be fully justified in terms of government policy in an unbroken chain of approved documents, which have been reviewed and signed by the head of every staff organization that might need to participate in the decision–making process.

17.25 This appears to be a very logical and thorough management process. In practice, there are three major problems for a department involved in procuring military equipment.

The Defence Program Management System generates an enormous staff workload

17.26 The first problem relates to the enormous staff workload needed to implement this cumbersome process. Our analysis of all projects over $10 million identified in the Defence Services Program (DSP) as of February 1991 revealed that it takes an average of 1,109 days from the time a project is first identified in the DND database until the Statement of Capability Deficiency document is approved. It takes an average of 1,107 days for the Program Planning Proposal to be approved, 1,608 days for the Program Development Proposal, 1,332 days for the Program Change Proposal, and 394 days for effective project approval by the Treasury Board. These average times between individual stages of the Defence Program Management System and the number of times these documents are amended and recirculated provide a good indication of the amount of staff effort involved. The Defence Planning and Force Development process also consumes staff effort, but we were unable to find useful hard data similar to that available for the DPMS.

The Defence Program Management System has almost never been followed as designed.

17.27 Although these average times between documents are indicative, they cannot simply be added together to get the average total time from project inception to Treasury Board approval because, in practice, the DPMS is virtually never followed as conceived. Only 16 percent of the projects that eventually received effective project approval had an approved Statement of Capability Deficiency or its equivalent, only 30 percent had a Program Planning Proposal and only 33 percent had a Program Development Proposal. A Program Change Proposal (PCP) was approved in 95 percent of the projects, primarily because this is the final approval step in the Department before effective project approval is sought from Treasury Board following Cabinet approval where necessary. In those cases where the DPMS has been completely by–passed, the PCPs are generally drafted and approved after the fact.

17.28 Because virtually all projects skipped at least one of these stages and most skipped several stages, only 3.3 percent of all projects went through the complete process. Nevertheless, the average length of time between the point where a project was first identified in the Defence Services Program and the point where effective project approval was obtained was five and a half years.

17.29 To complicate matters further, these documents are frequently produced and approved out of sequence. For example, the final document, the Program Change Proposal, may be produced and approved before a document earlier in the sequence, such as the Program Development Proposal or the Statement of Capability Deficiency.

Industrial development initiatives attached to DND major Crown projects have had an adverse effect on the Defence Program Management System

17.30 The second problem, and another reason why the actual use of the DPMS is not consistent with its design concept, relates to our observations in the previous chapter concerning the current implementation of the government's procurement policy in the area of industrial development initiatives attached to major Crown projects (generally projects costing over $100 million). At the very earliest stage of the project life cycle, the departments responsible for procurement and industrial development are already influencing the cost, the timing, the type of equipment ultimately selected and, in some cases, even the selection of the contractor. In some cases, the DPMS process is by–passed and contracts are awarded on a sole–source basis even before DND can properly identify what it needs and when it needs it. The production of DPMS documents and their approval within DND after contracts have already been awarded creates an extra workload and does little to ensure value for money.

Dynamic instability is inherent in the basic design concept

17.31 The third problem relates to the dynamic instability that is inherent in the basic design concept of the Defence Planning and Force Development process and the Defence Program Management System. They form a hierarchical, sequential process that starts with current government policy and the current geopolitical situation. The force structuring process then proceeds on the assumption that the armed forces should be structured and equipped to deal with missions and tasks assigned by government. In DND, the project initiation and project implementation processes are very lengthy, as are the contracting and manufacturing processes. It is unrealistic to believe that today's assessment of what constitutes appropriate missions and tasks will be the same up to ten or fifteen years later when the equipment actually arrives in field units. Even then, the in–service life cycle of military equipment can be as long as another twenty or so years before replacement.

17.32 World circumstances and the perceptions of governments concerning what armed forces missions and tasks constitute an appropriate response to the world situation change frequently. As one official in DND commented, the Defence Planning and Force Development Process "... has the potential to be extremely laborious in practice and the intervals between changes in key inputs — namely government policies and the military threat — are likely to be considerably shorter than the time taken to complete the entire process... There is a danger, therefore, that a sequential process will degenerate into a state of 'dither'."

The force structuring process should provide stability

17.33 It is not practical in peacetime for a country as small as Canada to attempt to tailor equipment and personnel structures with a 20- to 35–year life cycle to every new vision of what tasks and missions for the forces are thought suitable at any given time. Typically, military organizations must be capable of dealing with the unforeseen as well as the foreseen. Generally, they are structured to be capable of responding to the most complex and challenging role, participation in large–scale combat on a modern battlefield, in the full knowledge that this will also permit them to handle less difficult situations with relative ease. These structures tend not only to be multi–purpose, but also flexible in their capability to split off and recombine organizational elements of various sizes to handle specific, relatively short–term tasks before they are returned to their parent formations for new tasking.

17.34 The world has just lived through a dramatic example of rapidly changing geopolitical circumstances. The Defence Services Program that we audited was based largely on the threat posed by the Warsaw Pact as it was perceived during the 1970s and 1980s. With the benefit of hindsight, it is now possible to see that both military and civilian strategic assessments had failed as a useful prediction of what might happen next. The Defence Services Program was full of projects designed to provide a small, Canadian "force–in–being" with sophisticated equipment to help stalemate a Warsaw Pact onslaught in central Europe.

17.35 Even when it had become obvious over the past two or three years that this estimate of what is most likely to happen had been unrealistic for some time, the Defence Program Management System continued to process much the same list of projects. Today, the pendulum is swinging rapidly in the other direction. The Canadian Armed Forces are being reduced and equipment projects amended or cancelled, all in the light of what seems now to be the way the world will unfold. It is not clear that this forecast of future events will be any more accurate or durable than the ones that preceded it.

17.36 In our 1984 Report, we noted that the policy planning process in DND that is supposed to link government policy and the deficiencies in the equipment needed to fulfil that policy had never been successfully completed. Since that time, the policy planning process has been amended and made even more complex, but with much the same result. Few DND projects, if any, proceed through the policy planning and DPMS processes as they are currently conceived. This is not just a matter of skipping steps in the process for individual projects where they are not absolutely essential, it is a failure of the entire process itself.

17.37 In response to our recommendations in previous reports, DND has been working to develop a suitable long–term force structure. We have been recommending such a force structure as a base for expansion in time of serious emergency, during which the Reserves could be mobilized and the forces expanded through increased recruitment. This force structure for the longer term, designed for combat but reduced in peacetime to a core for expansion, would need also to be generally suitable for any tasks that government might reasonably assign over the medium and longer terms.

17.38 DND has responded by creating a special organization for operational planning and force development. Progress has been made, but current force structuring still appears to be focussed on what is needed for specific missions and tasks, and it is linked to an equipment acquisition process that is still sequential in concept and design. As a result of our work

Good program management in DND requires effective, day–to–day monitoring and control of the huge matrix of the 550 projects in the Defence Services Program.

on this and previous audits, we observed that this approach has not worked. The obvious alternative is to focus on a process that is less scenario–dependent. This could involve a general–purpose, flexible structure for the longer term that has been designed as a basis for expansion if and when needed. This would provide the stability that is essential for equipment and personnel planning and, at the same time, would provide Canada with the capacity to respond adequately to a wide variety of contingencies. Although there are indications that DND has been moving in this direction over the past several years, existing systems still appear to function much as they always have.

17.39 In its work on force structure development, DND should focus on the longer term and the stability that is essential to good equipment and personnel planning. This work is a prerequisite to the simplification and streamlining of the Defence Planning and Force Development process and the Defence Program Management System.

Department's response: *DND has recognized the need to simplify and streamline the Defence Program Management System, including the Defence Planning and Force Development process. To that end, a major reorganization, personnel reduction and realignment of responsibilities was implemented in National Defence Headquarters, effective 15 July 1992. Procedures for Capital Projects are currently under review, and amendments to the Defence Program Management System manual will follow.*

The program control process requires improvement

17.40 Aside from the process through which projects are identified, justified and approved, good program management involves the day–to–day monitoring and control of the vast matrix of some 550 projects in the Defence Services Program. These projects, costing altogether some $63 billion, proceed through life cycles of different lengths. At any given time, some are just being initiated and others are nearing completion. Throughout their life cycles they change dramatically as requirements change, costs are refined, priorities change and schedules for planning, production and delivery change. Some are cancelled entirely, others are postponed well into the future and still others are accelerated rapidly for one reason or another. Fundamental changes in priorities within the overall program occur as projects fall behind schedule, are advanced or are replaced by others to balance the expected annual expenditure indicated in the Estimates.

17.41 Almost daily or weekly, the huge DND matrix of projects experiences changes that require management attention and informed decision making. Failure to respond promptly and effectively can prove costly both to DND and to the Crown, in terms of expensive delays, and funds spent on lower–priority projects when they could have been made available for more urgent projects that would provide better value for money.

17.42 These considerations demand a program control system capable of recording and monitoring all the important attributes of individual projects and the changes in these attributes as projects move through their individual life cycles. This information would need to be condensed and suitably presented to senior management in a timely fashion and in a suitable form that would ensure that corrective action could be initiated immediately when significant changes occurred.

17.43 Although official DND documents describe the DPMS process in great detail, we did not find any description of how the complex business of managing the entire program of individual projects is to be achieved. The Defence Services Program Information System (DSPIS), a huge database that records the details of projects as the various approval documents are submitted and reviewed by the Program Control Board, does provide information on the Defence Services Program, but the system is not designed to give senior management the kind of information needed to manage the program efficiently. There is some form of priority setting within the army, navy and airforce but, overall, we did not find a comprehensive or efficient process for setting and amending priorities or for the day–to–day monitoring and management of the entire Capital Program.

17.44 An improved system for the day–to–day management of the Defence Services Program should be designed and incorporated in the Defence Program Management System.

Department's response: *Procedures for the management of the Defence Services Program, including regular review by responsible resource managers and Force Development staff, are in place and are reported to the Program Control Board. The amendment to the Defence Program Management System manual, referred to previously, will include these procedures.*

17.45 The DSPIS, and in particular the process that feeds it, is cumbersome and not well suited to assist the efficient day–to–day management of the Defence Services Program. We found that it was almost impossible to obtain aggregated historical information from the DSPIS to monitor actual performance and isolate problem areas and trends for management purposes.

17.46 The Defence Services Program Information System should be redesigned and made more suitable for day–to–day management of the program. It should be designed to be connected to project management information and reporting systems.

Department's response: *Defence Program Management System reform studies will lead to the identification of streamlined processes that should significantly improve the quality and the rate of inputs to the Defence Services Program Information System data base.*

17.47 There does not seem to be an overall system of priorities that would facilitate efficient program management and there is no direct feedback from the information in the Project Management Office databases to a database that could be used for program management.

17.48 A system of priorities should be established and managed for the entire Defence Services Program.

Department's response: *A system of priorities does exist in the Department as evidenced through the Canadian Forces Development Plan and Defence Services Program update process utilized under normal management conditions. Under Vice-Chief of the Defence Staff control, the Department is about to begin Defence Program Management System reforms that will, by mid–1993, provide the basis for the full documentation of these primary and the numerous supporting management processes currently in place. For emergency operations, the J3 Crisis Action Team system has demonstrated that priority issues can be successfully dealt with within extremely tight time constraints.*

Although the Defence Program Management System is described in great detail, we did not find any description of how the complex business of managing the entire program of individual projects is to be achieved.

Project Management Concerns Are Often Linked Back to Program Management

17.49 Our entity for this line of enquiry consisted of all DND projects currently under way between $1 million and $1 billion that also have had deliveries of equipment under the contract. Because of their size and magnitude, we examined major Crown projects over $1 billion separately, using a judgmental sample. The entity subjected to dollar–unit sampling

Virtually all of the projects we examined in our representative sample experienced schedule delays and several had significant cost escalations.

consisted of 60 projects, amounting to approximately $3.8 billion, in which end products had actually been delivered. Our statistical sample for examination included eight projects with a total project value of $1.25 billion. In addition, we examined three very large projects over $1 billion each for a total project value of $3.75 billion, to extend the sampling process to this category.

17.50 The projects selected for examination and their associated project costs are shown in Exhibit 17.1.

17.51 Although DND considers that project management commences as soon as the requirement for a project is first identified, the Project Manager plays a subordinate role to the Project Director during the project initiation phase. The Project Manager's primary responsibilities during the implementation phase include contract management in conjunction with the Department of Supply and Services, schedule monitoring and management, control of change orders, approval of progress claims for deliverables, quality control and acceptance.

17.52 The projects we examined in our sample were either off–the–shelf purchases or turn–key procurements, in which a prime contractor is responsible for all project management and for delivery of the final product within time, cost and performance parameters spelled out in the contract. We believe that this is typical of the 60 projects in the population of projects in which end products have actually been delivered.

17.53 These kinds of projects do not require extensive day–to–day management of all of the details of the production process by the DND project management team. In the turn–key projects, this is the responsibility of the prime contractor. Off–the–shelf purchases require relatively little detailed project management. In effect, the DND project management team exists primarily to monitor the progress of the project and to inform senior decision makers in the Department if significant difficulties arise that might jeopardize compliance with the contract. This is not to minimize the serious responsibilities of these teams, but merely to point out that they exist primarily to monitor the results of the prime contractor's project management efforts.

17.54 We found that virtually all of the projects we examined experienced schedule delays and, in several cases, significant cost escalations. The reasons varied from project to project, but in almost every case the problems stemmed from the shortcomings very early in the project life cycle during the project initiation phase – shortcomings that were described in the previous chapter and in the section of this chapter dealing with Program Management. There were also instances of significant adverse effects caused by the industrial development initiatives early in the project life cycle. None of these projects followed the DPMS process from the policy planning process throughout their life cycles and most were subject to several changes in priority, scheduling and cost before they were finally approved. None of the schedule changes or cost increases appear to have been caused by the DND project management process after the Project Managers assumed prime responsibility for the projects.

Exhibit 17.1

List of Projects Examined

Project Name	Estimated Project Cost (in 1990–91 – millions)
Airfield Damage Repair	$ 34.9
Canadian Towed Array Sonar System	128.2
Canadian Electronic Warfare Systems	55.3
CF–18 Air–to–Air Missiles	337.7
Heavy Logistics Vehicle Wheeled	379.1
Torpedo Defence System	13.5
Automated Data Processing – Foundation Group of Systems	217.7
Maritime Air/Sea Torpedoes	84.1
North American Air Defence Modernization	1,288.9
Low Level Air Defence	1,077.7
Tribal Class Update and Modernization Project	1,380.7
	$ 4,997.8

17.55 Although we did not note any significant cases of failure to deliver products that met the technical and operational requirements, some of the larger projects are still in progress and some have not yet been fully accepted by DND.

There is an Opportunity to Reduce the Costs of Initial Provisioning Spare Parts

17.56 In 1988, we reported that excessive amounts of spare parts were being procured and stocked by DND. This was particularly true of initial provisioning spare parts. In this audit, we concentrated on the prices paid for initial provisioning spares.

17.57 Initial provisioning essentially involves the acquisition of sufficient spare parts to allow the operation of the weapon system for an initial period, usually two years. In some cases it is necessary to buy a lifetime supply, if these spares will not be produced after the weapon system is delivered.

17.58 DND through the Department of Supply and Services normally acquires these initial provisioning spares from the prime contractor, to minimize overall project risk to the Crown by ensuring that the prime contractor's total system responsibility and warranty against defects are maintained. As a rule, the prime contractor is asked to identify the kinds and quantities of spare parts that should be bought as initial provisioning spares. The lists of spare parts proposed by the prime contractor are scrutinized by DND officials from the standpoint of the numbers required, their costs, the authorized DND operational plan, and its weapon system maintenance plan.

17.59 These initial provisioning lists can be extensive. In some cases, they run to tens of thousands of different kinds of spare parts. Some spares are very complex and expensive and others are as simple as nuts and bolts. Given the complexity of these lists and the specialized knowledge of the contractor's staff involved in the design and production of the complete piece of equipment, government officials reviewing the lists can be at a disadvantage regarding detailed knowledge of items, open market prices and mean–time–between–failure assumptions for any new equipment that does not yet have a serviceability record based on actual usage. In an effort to reduce this disadvantage, DND uses a broad range of expertise to challenge the accuracy and applicability of all contractor data and to make procurement decisions.

17.60 We obtained a listing from DND of all initial provisioning contracts in effect at the time of our audit. The contracts date from as early as 1982 and have a total cost of $657 million.

17.61 We selected a statistical sample to make price comparisons. Two kinds of comparisons could be made:

- comparing the item purchased to an identical item sold elsewhere at the same time; and
- comparing the item to commercially available items with similar capabilities (value engineering analysis).

We compared prices paid by DND for initial provisioning spare parts with the listed prices of items available for sale or actually paid by the U.S. Department of Defense.

17.62 We focussed only on the first comparison, and limited ourselves only to those parts where price comparisons could readily be made. This involved $158 million in spare parts contracted over a ten–year period. We compared the prices paid by DND with the listed prices of the same items available for sale or actually paid by the U.S. Department of Defense.

17.63 We recognize that the actual price that Canada would have paid for these items may differ from those we compared, but our analysis indicates that those prices are generally reliable. We also recognize that alternative sourcing does not take into account certain risks such as availability of specialized items, configuration control and warranty considerations, as

Our analysis indicates that there is an opportunity to reduce the amount paid for initial provisioning spare parts by using modern technology.

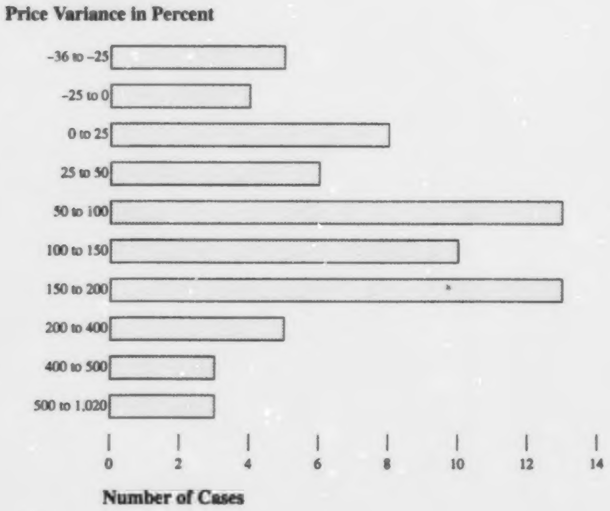
well as any additional costs associated with administrative overhead.

17.64 The results of our analysis are contained in Exhibit 17.2. The differences between the prices paid by DND and the prices indicated in these other sourcing alternatives varied widely, but in the majority of cases exceeded 50 percent. We recognize that the tools and technology were not available when most of these initial provisioning contracts were put in place and that there is some uncertainty about whether the items could have been bought for the lower price. We believe, however, that our analysis indicates that there are more cost–effective alternatives for purchasing spares.

17.65 Both DND and the Department of Supply and Services are taking steps toward improving their procurement approach. For example, DND is implementing the Buy Our Spares Smarter (BOSS) project. In addition, in April 1991 Supply and Services began implementing a Canadian Item Information Service that includes spare parts pricing and sourcing information for both U.S. and Canadian defence requirements. We believe that it is important that these initiatives be expanded and reinforced, since even a 10 percent reduction in initial provisioning procurement costs could result in savings in excess of $20 million each year.

Exhibit 17.2

Initial Provisioning
Distribution of Price Comparisons



17.66 The departments of National Defence and Supply and Services should reconsider the practice of procuring initial provisioning spares primarily from the prime contractor and consider other options, including acquisitions directly from the original equipment manufacturer, the United States Department of Defense and other cost–effective suppliers. Cost comparisons similar to the one used for this audit should be adopted, preferably prior to contract award, for all procurement of initial provisioning spares. Value engineering analysis should also be carried out as part of the specification process to ensure that the most cost–effective part is being procured.

Department of National Defence's response: *DND will reconsider the practice of procuring initial provisioning spares only from the prime contractor. Furthermore, DND will expand the use of the BOSS project in the initial provisioning process and investigate the applicability of the value engineering analysis, sampling and cost comparisons in the initial procurement of spare parts.*

Department of Supply and Services' response: *We agree with the Auditor General's recommendation under 17.66. On a case–by–case basis this will be taken into account when developing the procurement strategy for all new major Crown projects.*

Supply and Services will continue to extend the use of the Item Information System, which was implemented in April 1991 to do cost comparisons similar to that conducted by the Auditor General.

Chapter 18

Department of National Defence

The Canadian Forces Reserves

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Department of National Defence

The Canadian Forces Reserves

Assistant Auditor General: David Rattray
Responsible Auditor: Tom Hopwood

Main Points

18.1 The Canadian Forces Reserves are an essential component of the armed services. Reserves now cost about $750 million each year, and by the year 2000 will represent 46 percent of Canadian Forces personnel. Recent policy changes call for a revitalized Reserve that will play a more important role.

18.2 Our audit indicates that the Reserve system as it is presently constituted provides only limited military capability. The Department of National Defence has recognized many fundamental problems that must be addressed.

18.3 The Department will need to fill many gaps in planning. In particular, it will need to determine the most cost–effective roles and employment patterns for Reservists. Our audit indicates that, under the existing model, most of the cost advantage expected from the largest Reserve component is lost. The Department also needs to devise policies that will ensure reliable turnout of Reservists for training and in emergencies.

18.4 Existing human resource management processes for the most part do not respond to the part–time nature of the Reserves. Reserve occupations, training and promotion standards are disconnected from operational requirements, and training and promotion standards are not enforced. Systems, although under review, have not been designed to accommodate the limited availability of Reservists. With notable exceptions, the same applies to recognition of Reservists' civilian skills.

18.5 We identified problems with the acquisition of supplies, equipment and facilities that also reinforce the need for an approved and affordable plan for the Reserves. Capabilities are compromised because of funding problems, and the full rationale for projects is hard to determine in many cases.

18.6 Accountability for Reserve performance, both within the Department and to Parliament, needs to be dramatically improved.

18.7 The Canadian Forces recognize that overcoming these problems will probably be one of their greatest challenges over the next decade. Major reorganization, human resource management and re–equipment programs are being undertaken to address many of the issues raised by this audit.

Introduction

18.8 Historically, the Reserves have formed an essential part of the Canadian Forces. Before the Second World War, the Regular Force was primarily a cadre for training the Reserves and never numbered more than a few thousand. The Reserves outnumbered the Regulars immediately after World War II, but with the coming of nuclear weapons military forces had to be ready to fight a war that might be measured in a few days or even hours. As a result, the Regular Force became the dominant component of the Canadian Forces and the Reserves entered a prolonged period of decline. They were not included in all aspects of the unification of the armed forces, and they continued to have separate management systems and practices, especially for human resources.

18.9 The isolation of the Reserves resulted in long–term, systemic problems that the Department has only recently begun to address. Many of the deficiencies noted in our audit will require considerable time to correct and are beyond the capability and authority of Reserve units and headquarters in the field to resolve. In many cases, a service–wide solution is required.

18.10 The Department's current policy makes it critical that the Reserves be an operational part of a Total Force. The Department is integrating Regulars and Reserves at the same time as it reviews and modifies the overall structures of the Department and the Canadian Forces.

18.11 Canada's armed forces are made up of the Regular Force — about 84,000 individuals who serve full time — and about 76,000 Reservists, including:

- 29,000 Primary Reservists who average about 60 days of service each year. The Primary Reserve consists of the Naval Reserve, the Militia, the Air Reserve and the Communication Reserve;
- the Supplementary Reserve, a pool of former members of other Canadian Forces components who could be called upon in an emergency. It has two parts: a Supplementary Ready Reserve of about 10,000 who have volunteered for early service in any emergency and who have "reasonably current" military skills, and a Supplementary Holding Reserve of 28,000 who are neither current in skills nor immediately available;
- the Cadet Instructors List of 6,400 officers whose primary duties are the supervision, administration and training of Sea, Army and Air Cadets; and
- about 2,500 Canadian Rangers who provide a military presence in sparsely settled, northern, coastal and isolated areas of Canada that cannot be covered conveniently or economically by other elements of the Canadian Forces.

18.12 The Reserves are managed within the context of the "Total Force" concept. This means that units may be formed from Regulars and Reserves working together as with Militia and Air Reserve squadrons; or they may exist separately but work within the same operational organizations, as with the Naval Reserve. Total Force has been the policy of the Department since 1971, but until 1987 the primary job of the Reserves was to augment the Regular Force. "Augmentation" means taking Reservists from their units and employing them in positions in the Regular Force structure. The 1987 White Paper, Challenge and Commitment: A Defence Policy for Canada, redefined "Total Force" to emphasize the assignment of unique wartime roles to Reserve forces.

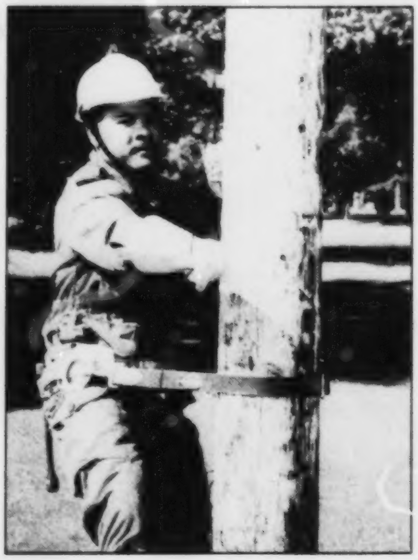
18.13 The Department has not defined Total Force in detail, instead allowing each Command to decide how

The isolation of the Reserves resulted in long–term, systemic problems that the Department has only recently begun to address. Many of the deficiencies noted in our audit will require considerable time to correct and are beyond the capability and authority of Reserve units and headquarters in the field to resolve. In many cases, a service–wide solution is required.

it would implement the concept. Each Command selected its own path within the general policy, based on its unique needs and previous force development planning.

18.14 In September 1991, the Minister of National Defence made a new statement of defence policy that responded to international changes, principally the collapse of the Warsaw Pact and the decline of the Soviet Union. The Minister reaffirmed the doctrine of "Total Force", announcing a decrease in the Regular Force and an eventual increase of the Primary Reserve from 29,000 to 40,000 by 2006. The Supplementary Ready Reserve would increase from 10,000 to 25,000 by 1994. The Minister reaffirmed major programs announced in the 1987 White Paper to re–equip the Reserves.

18.15 Reserves are growing in importance and are becoming an increasingly large portion of the Canadian Forces. The Primary Reserve and the Supplementary Ready Reserve now provide 32 percent of the armed forces overall. By the year 2000 this



Reserves form an important part of Canada's defence (see paragraphs 18.8 to 18.11).

will grow to about 46 percent. Total Reserve expenditures for 1991–1992 were estimated at $742 million including capital equipment and assigned overheads.

Previous Studies

18.16 Since the Korean War, Parliament and the Department have made a series of attempts to reform and reorganize the Reserves, especially the Militia. There have been seven departmental reviews of the Reserves. In addition, they were reviewed in 1980 by the Minister's Task Force on Unification; in 1981 by the House of Commons Standing Committee on External Affairs and National Defence; in 1982 by the Senate Sub–Committee on National Defence; for the 1987 White Paper; and in 1989 by the Senate Special Committee on National Defence in its review of land forces.

18.17 These studies and reviews have repeatedly sought to define clear roles for the Reserves consistent with their character as part–time volunteers; to improve security of their civilian jobs and increase public support; and to improve their training and equipment.

18.18 This is our Office's first audit of Canada's Reserve Force. However, our previous audits of the Regular Force have commented on deficiencies in shared command, management and administrative systems. In particular, we have pointed out that the Department lacked a peacetime force structure for the longer term and recommended it develop one that was consistent with defence policy and available funding.

Audit Scope

18.19 The scope of our audit included the Primary Reserve and the Supplementary Ready Reserve. We did not audit the Cadet Instructors List, the Canadian Rangers or the Supplementary Holding Reserve. We completed our examination work in December 1991, and updated our report in response to departmental comment in July 1992.

18.20 We assessed the Reserves against a basic criterion: do they provide adequately trained and equipped forces in sufficient numbers to meet their assigned responsibilities with due regard to economy and efficiency? We linked observations at this level back to the Department's overall processes for policy, planning and resource allocation.

18.21 Our audit included tests and examination work at all the Command Headquarters. We based a significant portion of our detailed audit testing on a sample of 38 units in all four Commands — Maritime, Mobile, Air and Communication. Our tests of human resource management included a survey on personnel management practices, sent to all 5,200 members of the sample units. We also visited Canadian Forces Training System Headquarters, Militia Area headquarters and schools that deliver Reserve training. Eight members of the audit team observed the ON GUARD '90 exercise, and one member observed OCEAN SAFARI '91.

18.22 As we have already pointed out, each Command employs its Reserve component differently and, to a significant degree, manages its Reserves separately. Care should be taken in reading this chapter not to extrapolate results beyond the Commands that we assessed or to assume that all Commands are identical.

Observations and Recommendations

18.23 Implementing the Total Force policy and managing the Reserves effectively and efficiently will be one of the greatest challenges facing the Canadian Forces over the next decade. Our audit of the Reserves identified serious problems, which the Department of National Defence recognizes it must address over the next several

Our audit of the Reserves identified serious problems, which the Department of National Defence recognizes it must address over the next several years. The Department has several major initiatives under way to deal with many of these issues.

years. At the time of our audit the Department had several major organizational, human resource management and re–equipment initiatives under way to deal with many of these issues.

The Planning Framework for Reserves Needs to Be Strengthened

18.24 Having a cost–effective Reserve force requires good planning. The Department must employ Reserves in roles for which they are well suited. Planners and decision–makers must know what various options will cost and what they will produce, so that they can choose wisely. They must also have an effective means of keeping plans current in response to changes inside and outside the organization.

18.25 We examined plans for the Reserves made since the 1987 White Paper, especially those defining the "Total Force." We found that there were significant deficiencies, both in these plans and in the planning systems that produce them.

The roles for Reserves should be reviewed

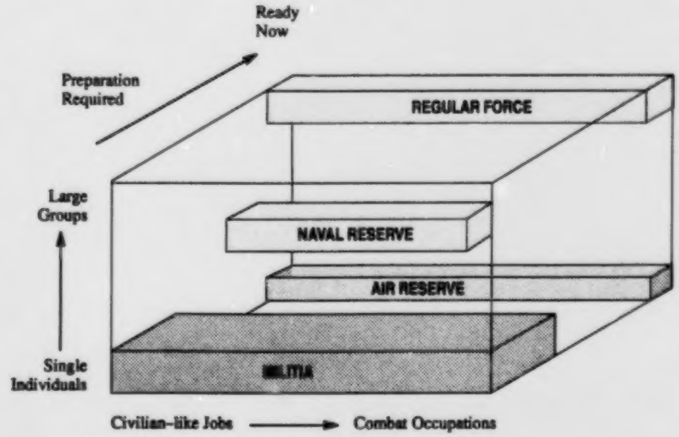
18.26 Reservists can be employed in a variety of functions, from combat tasks to rear–area support. They can also be at various degrees of readiness, available on short notice or later in an emergency. They can be used to augment the Regular Force as individuals, in small teams, or in entire units of hundreds of men and women. Exhibit 18.1 illustrates the trade–offs that must be made.

18.27 Our audit showed that the Department has based decisions of this kind on historical practice or on particular requirements, without ever fully assessing the use of Reserves overall. Although the Department has monitored experience of other countries in using Reserves, it has not conducted a comprehensive analysis of the employment of Reserves in the Canadian Forces.

18.28 We found that the Department did not adequately define how Reserves would be employed before redefining "Total Force" as the basis for the White Paper. The Department did not carry out a fundamental review of peacetime and wartime tasks to make the most appropriate allocation of Reserve and Regular forces, in either separate or combined units. We did find, however, that Maritime Command reviewed major roles for the Reserves, although it did not formally analyze options. Each of the four Commands has a different concept of Total Force, but no Command has systematically considered the costs and benefits of particular uses of its Reserves before assigning tasks. In Mobile Command, we found no documented justification for the existing mix of units, either by type or by number. Mobile Command considered a series of employment concepts before it accepted the current concept in fall 1991, but it has not yet determined the

Exhibit 18.1

Planners Must Make Several Trade–offs



To effectively employ Reserves, officials must choose the appropriate type of job, size of team, and degree of readiness (illustration is approximate only).

final composition and structure of the Militia.

18.29 At the time of our audit, Mobile Command was reviewing Reserve capabilities and land force requirements to design an organization based on current operational requirements. The Command intends to complete the project by February 1993.

Cost and benefit relationships need to be assessed

18.30 Measuring cost–effectiveness requires a comparison of the Regular Forces' combat capability with that of the Reserves, and a comparison of the resources required by each to achieve that capability. We found that the Department does not know the true costs and capabilities of the Reserves or how they compare with Regular Forces, because its accounting and management information systems cannot readily produce the necessary data. Individual Reservists are usually paid less than Regular Force members, but we could find no analysis to support the Department's assumption that, collectively, Reserves cost significantly less than Regulars for a comparable level of capability.

18.31 To test that assumption, we looked for an element of the Reserves that was roughly comparable to some portion of the Regular Force. We decided to study the Militia in Land Forces Central Area, which is intended to produce three Reserve combat arms battalions. We compared the costs with those of three Regular Force battalions.

18.32 We found the Regular Force units in our case study to be less than 10 percent more expensive to maintain than their Militia counterparts. Comparing capability, however, we noted that members of the Reserves are not as well trained or as operationally ready as those in the Regular Force.

18.33 Similarly, a preliminary departmental study of the Air Reserves concluded that, once readiness levels, turnout and attrition are taken into account, it may not be cost–effective to employ Reserves in some roles to which they have been assigned.

18.34 Other factors besides cost may impact on how Reserves are employed; these should be considered in assessing cost–effectiveness. They include the perceived benefits of improved links between the Canadian Forces and civilian society, and possible military advantages such as speedier mobilization. Such benefits currently are not evaluated or formally reported.

18.35 The United States Department of Defense estimates that it can field fully equipped Reserve units for between 20 and 85 percent of the cost of similar Regular formations, depending on their type. The Canadian Forces have yet to approach such savings, although more efficient organization and reduced attrition would certainly increase the cost advantage of Canadian Reserves. Clearly, the Department needs to address the question of the most cost–effective roles for the Reserves.

Assumptions about budgets were optimistic

18.36 We found that the Department had based its plans for the Reserves on optimistic budget estimates. Officials planning the 1987 White Paper estimated that an increase of 4 percent every year for 15 years would be needed to support the force being planned. They warned that restricting the increase to 2 percent a year would result in a $31 billion shortfall overall, requiring a substantial decrease in force levels and a withdrawal from Europe.

18.37 The government, however, based the 1987 White Paper on a 2 percent increase, plus unspecified "bumps" to be negotiated in subsequent years. These "bumps" were not forthcoming, and federal budget reductions from 1989 on have meant that National Defence expenditures have

Each of the four Commands has a different concept of Total Force, but no Command has systematically considered the costs and benefits of particular uses of its Reserves before assigning tasks.

increased by only a fraction of 1 percent since 1987. This resulted in significant shortfalls in programs for Reserve equipment and facilities.

Measures to ensure reliable availability of Reserves need improvement

18.38 The "Total Force" planned by the Department requires that large numbers of Reservists turn out reliably for training and for emergency duty. Unlike previous plans, which viewed Reserves primarily as individuals to augment a large full–time force, Total Force plans assign entire roles to Reserve units who must therefore train and turn out together. We found, however, that the terms of service set out for Reserves in the National Defence Act do not fully support the Total Force concept, and the Department has not taken the management measures needed to overcome this problem.

18.39 The United States prevents employers from penalizing Reservists for absence due to training or emergency service, and Australia, Britain and New Zealand protect Reservists during an emergency call–out. Unlike them, Canada does not have legislation to protect the jobs of Reservists who volunteer to serve. It relies instead on the voluntary support of employers. The Department recognizes that a gap exists in federal government policy and, at the time of our audit, was working on a proposal for job protection legislation for emergencies only. The work completed thus far would allow the Department to reduce its response time in an emergency.

18.40 Under the National Defence Act, members of the Reserves are not on active service when in Canada, and cannot, in practice, be compelled to train or serve unless placed on active service by an order–in–council. There is no legal impediment to issuing an order–in–council, but it would be unprecedented. The government has not placed the Reserves on active service since World War II. Officials told us that they viewed issuance of an order–in–council as a political matter: if the government were unwilling to act, it would have to accept a lesser military response.

18.41 The policy basis for Reserve service thus relies solely on the individual to turn out for training and for duty, while providing no security for volunteers' jobs or income or the well–being of their families.

18.42 We believe that the Department needs to make greater efforts to develop other means of ensuring turnout for training and operations. The Department has a National Employers Support Committee of prominent volunteer business leaders who encourage employers to allow Reservists time off for training and service. But the Department has provided the Committee only minimal staff support. The Department has assigned four full–time individuals to the program and plans to add 15 officers who would work two days a month. This secretariat has no advertising budget and has only a small budget to fund familiarization visits by employers. Officials could identify only 19 firms that support Reserve service. The Department does not know who employs incumbent Reservists.

18.43 The Department has also not taken a full and adequate range of measures to make turnout more reliable. Unit commanders often do not dismiss individuals from the service for non–attendance until long after they stop meeting the Canadian Forces' definition of an "effective" member. Contracts or undertakings with Reservists to require their reliable turnout for training are not used, nor are Reservists informed on enrolment about the Department's expectations in the event of a call–out. The Department has done little to make training as convenient for typical working people as for students, who are available for lengthy training during the summer.

18.44 Although Reservists have responded well to a number of relatively small–scale taskings, the Department has estimated that only about a third of Reservists would turn out during an emergency. Unit commanders we surveyed estimated that less than half would turn out for a combat assignment outside Canada. As we show later in this Chapter, many of those who would turn out would not be trained to the necessary standards, in part because they may have been unavailable to undertake the required training.

Planning processes can be improved

18.45 Beginning in 1984, our audit reports have recommended that the Department of National Defence develop an affordable force structure plan on which to base management decisions. The Department's management process requires the Department to transform policy guidance and concepts into a detailed force development plan. In 1988 the Department issued a provisional development plan, but was unable to update and complete it in 1989, 1990 or 1991. The same gaps remain that were identified in 1987 at the end of the White Paper development process and detailed in the development plan.

18.46 We attempted to find out whether the Department had developed any further plans before the Minister's September 1991 statement on defence policy, which dramatically changed many existing commitments and forces. Department officials could not provide us with force structure plans or analyses on which the Minister's statement was based. They did show, however, that basic alternatives had been "modelled" to ensure that the total number of people would fit within budget limits. We reviewed the guidance document issued by the Chief of the Defence Staff to senior personnel charged with producing the new plan. It instructs planners to adopt the existing Regular/Reserve ratios which we found had not been based on systematic analysis.

18.47 In July 1992 the Department issued a draft Canadian Forces Development Plan that is intended to be the baseline planning document for coherent resource planning. The Department recognizes that much more work remains to be done to overcome the limitations of the plan. This work includes: identifying the war and peace establishments, and the positions within the establishments for the Reserves; defining readiness requirements; and assessing the affordability of the Development Plan. The Department has set an objective of issuing a final Canadian Forces Development Plan in December 1992. Officials told us that they intend to adjust the plan annually in response to an annual defence policy statement by the Minister.

18.48 The Department should employ Reserves in the most cost–effective manner. In particular, the Department should:

- **develop cost–effective employment concepts and an affordable force structure for the Reserves. Factors such as the rationale for Reserves, objectives achievement, cost–effectiveness and alternatives, potential positive and negative effects, social benefits and military advantage, and inter–program relationships should be explicitly included;**
- **take measures to ensure that Reservists are available for training and emergencies;**
- **put systems in place to provide Commanders with information on the relative costs and benefits of Regulars and Reserves; and**
- **further develop and implement planning systems to ensure that resources are employed effectively and operate in a timely fashion.**

Department's response:

- *Concur. The new concept of Total Force requires a mixture of existing and new force structuring techniques. The draft Canadian Forces Development Plan has been issued. Missions, tasks, readiness and contingency plans and guidelines, and war establishments are being prepared which include the operational employment of Reserves within a Total Force. The Operational Readiness and Effectiveness System is being adjusted accordingly.*

  Cost–effective means to support the Reserve are an important aspect of ongoing departmental infrastructure activities and management reviews and initiatives. These include the Operations and Maintenance Working Group, costing the Canadian Forces Development Plan, and efforts to better link activities to resource management.

  A review of the military occupational structure is assisting in identifying areas for the effective employment of reservists within the overall personnel structure of the Department.

- *Support to the National Employer Support Committee will be enhanced, and liaison with employers and support to serving reservists has been increased.*

  The needs of an effective Reserve will be considered as part of an internal review of the National Defence Act.

  Personnel policies and compensation and benefits for reservists will be reviewed with a view to encouraging voluntary attendance.

  Methods of monitoring and improving attendance will be developed. These will employ a combination of routine reports and evaluations, and a systematic program of applied personnel research.

- *Relevant cost information is expected to be provided by: improved management information systems such as the Reserve Integrated Information Project and the Interim Reserve Pay and Personnel System; the military occupational structure review; revisions to operational effectiveness reporting; and further delegation of resource allocation to Commanders.*

- *The force development process, coupled with mobilization and contingency plans and revisions to operational effectiveness reporting, is addressing the effective and timely employment of reservists on operations. Existing project management procedures can synchronize acquisitions with training and support activities. Recent NDHQ reorganizations have strengthened the Department's ability to monitor structure and activity developments, including those which apply to the Reserve.*

Human Resource Management Systems Can Be Improved By Better Matching Part–time Volunteers to Operational Requirements

18.49 The central challenge of human resource management in a Reserve force is to harmonize the strengths and weaknesses of part–time volunteers with the operational requirements of the armed services. Volunteers can bring with them transferable trade, specialist and leadership skills developed in their civilian occupations. Because they have full–time civilian occupations, Reservists will have only a limited amount of time available each year for training, and then only when there is no conflict with their civilian jobs. Reserve occupations and tasks must be carefully selected to ensure that operational standards are attainable within the limited time available for training.

18.50 We found that, in general, the Canadian Forces have not succeeded in designing personnel policies that match part–time volunteers to operational requirements.

Establishments and rank structures in most Commands need to better reflect operational requirements

18.51 An "establishment" is a formal organization plan for a military unit that details the occupations and ranks of individuals within it. Establishments must cover both the peacetime and the wartime operational requirements of a unit. If not, the unit may lack appropriate skills or leadership or be inefficient and expensive to maintain.

18.52 We examined the establishments and rank structure of the Naval Reserve, Militia and Communication Reserve. These account for 95 percent of the Reserves.

18.53 Our audit assessed two factors: whether the Department had based establishments on operational requirements; and whether operational requirements had determined the ranks within those establishments.

18.54 We found that, in the Militia and the Communication Reserve, the Commands had based unit establishments on neither peacetime nor wartime operational requirements. In the Militia, all units are covered by the same generic Canadian Forces Organization Order. The vast majority of Militia units have no assigned roles or operational tasks, and have been organized on the model of Regular Force operational units. Communication Reserve units function as training organizations, but they, too, are organized like Regular Force operational units. But Militia and Communication Reserve units are only half the size of their Regular Force counterparts, or smaller. Rank assigned to positions within establishments does not appear to be based on requirements. We could not find the rationale for the existing rank structure.

The vast majority of both Militia and Communication Reserve units have no assigned roles or operational tasks, and have been organized on the model of Regular Force operational units.

18.55 Since 1989, Naval Reserve Divisions have been organized to contribute teams to units in a war establishment, providing a basis for the rationalization of personnel. This war establishment, however, has not been approved by National Defence Headquarters; without a force structure plan, we could not determine how accurately it reflects current requirements.

18.56 In addition, we examined how establishments were actually manned. We compared the number of officers and senior non–commissioned officers in Reserve units to those in the Regular Force by matching the proportion of individuals at one rank level to the number of individuals in the rank level immediately subordinate. Our results are shown in Exhibit 18.2. In general, the Reserves have proportionately twice as many senior officers and senior non–commissioned officers as does the Regular Force. No requirement for senior grades has ever been established based on the need to expand rapidly under conditions of full mobilization.

18.57 The proportion of supervisors to subordinates would be even higher if based on the number of individuals active in the unit. A Militia Lieutenant–Colonel, for example, leads a unit of 200 to 300 positions, but only an average of about 100 people. In the Regular Force, a sub–unit of 100 people would be led by a Major, while a Lieutenant–Colonel would be in charge of about 600. There are no instructions that require unit Commanding Officers to fill their units efficiently. We found that the upper level positions in Militia units tended to be filled instead of having fully manned sub–units.

The occupational structure in most Commands could better reflect unique Reserve requirements

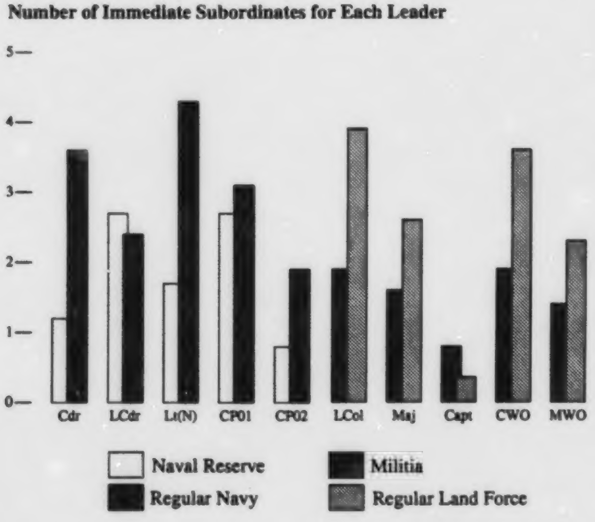
18.58 The purpose of a military occupational structure is to provide the framework within which personnel are recruited, trained, employed, posted, and paid. The structure is primarily designed to identify the skills and knowledge necessary for personnel to do the jobs required by the Canadian Forces.

18.59 We examined the extent to which the current Reserve Force Occupational Structure meets the Canadian Forces' needs. We also examined whether Reserve occupational specifications are an adequate basis on which to develop training, promotion and compensation policies. This aspect of our audit included three Reserve elements out of four. We excluded the Air Reserve, because it uses Regular Force occupational specifications.

18.60 The existing Reserve occupational structure has many serious deficiencies. The Department did not base it on a systematic analysis of operational requirements to meet defence objectives. The Department has not reviewed the structure for non–commissioned members for at least 15 years, in spite of changes to the role of the Reserves. We found a defined operational requirement for only one of the officer occupations added since 1976.

Exhibit 18.2

The Naval Reserve and Militia Are Rank–heavy



18.61 The policy and the guidelines governing the development of Reserve occupational structures are the same as those used by the Regular Force. They do not recognize unique Reserve employment factors, such as Reservists' lack of mobility imposed by holding civilian jobs or by time constraints. The current policy gives no consideration to balancing operational requirements with the availability of Reservists.

18.62 Specifications outlining the duties and tasks and associated minimum levels of skill and knowledge for each occupation are generally poor in quality or non–existent. We found that about 40 percent of the Reserve officer occupations lacked specifications; two–thirds of the specifications for non–commissioned member occupations were out–of–date or non–existent. Specifications that did exist were in several versions or types that were not consistent with each other. Many of them specified levels of skill and knowledge below the minimum generally required by Canadian Forces guidelines. Others ignored the constraints on Reserve availability for training and set standards so high that it would take a long time for an individual to reach the most basic qualification level. In one case, it would take over 10 years, compared to 21 months for a member of the Regular Force, who completes significantly more training.

18.63 We believe that the existing Reserve occupational structure is inadequate as a basis for human resource management functions such as training, promotion or compensation.

18.64 The Department has begun corrective action by drafting "Canadian Forces Integrated Occupational Specifications." This initiative is intended to provide a consistent set of specifications for a Total Force. We found in the work done to date, however, that human resource managers have not always recognized the limited availability of Reserves for training and employment. In addition, officials estimate that even if additional staff resources become available, it will take seven years to complete the new specifications, although many will be finished much earlier and draft versions of later ones will facilitate improvements.

Recruiting could be better targeted

18.65 Recruiting is essential to ensure that an organization has enough people of the right type to meet its objectives. The Commands were able to recruit all, or nearly all, of the Reserves they needed during the recent period of growth. When we began our audit the recruiting process took too long and discouraged applicants, but by the time we completed our work Department officials had eliminated most of the major administrative impediments to timely recruiting.

18.66 We did find, however, that the Department had not targeted recruiting efforts well. Because the Reserves do not require individuals to sign up for a fixed period, and because members have commitments in their civilian lives, attrition is a serious problem. Attrition varied from 12 percent in the Air Reserve to 35 to 40 percent in the first year of service in the Communication Reserve. Mobile Command was unable to provide data for the Militia. Although some attrition is to be expected, high first–year attrition indicates inadequate screening of applicants. A 1989 departmental study stated that nearly half of the Primary Reserve members who quit did so before completing one year in the Reserve. Based on 1990 recruitment levels, the Department could save about $5 million annually in lowered recruiting and training costs if it could reduce attrition by 10 percentage points.

18.67 Although early attrition is a major burden in terms of wasted recruiting and training effort, personnel turbulence and decreased cohesion in units, the Department has not made special efforts to attract those most likely to stay. Why people leave depends on many factors but, according to a departmental study, the individuals most likely to leave are single, under 23 years of age and in high school when they enrol. They are motivated to join for money and job opportunities. Those who stay are more likely to be married, over 24 years of age, post–secondary school graduates and employed full time. They are motivated to join the Reserves for patriotic reasons. The same study found that a high proportion of former Regular Force members who joined the Reserves formed a long–term commitment.

18.68 We expected that the Department would make special efforts to attract recruits who were already skilled. We also expected that it would make special efforts to attract former Regular Force personnel. We found that, except for the Air Reserve and to a lesser extent the Communication Reserve, this was not so: few people in these categories were being recruited.

18.69 The selection process for Reserve applicants does not take unique Reserve factors into account. The Canadian Forces cannot assume that, like Regular Force members, Reservists will automatically be available for service or training. It is imperative, therefore, that interviewers ask applicants whether they will be available for training and would volunteer if called out. Recruiters do not routinely ask either of these questions — although applicants to the Supplementary Ready Reserve are asked to sign an undertaking to respond voluntarily to a call–out by the Chief of the Defence Staff. Training and call–out obligations are generally not explained in the recruiting process; our survey of Reservists showed that over 20 percent of those recruited might not have joined had they been aware that they were expected to take the necessary training.

Promotion policies and practices in most Commands need to improve

18.70 In any organization, promotions must be managed to ensure that individuals selected for leadership positions are both properly qualified and the best available. Our audit examined whether prerequisites for Reserve promotion were clearly defined and appropriate to a Total Force, and whether promotion practices were consistent with departmental policies.

18.71 Central to our examination was the fact that the Canadian Forces do not differentiate between Regular and Reserve rank. It plans to employ most Reservists in positions where they would work alongside Regular Force members. All Commands intend to develop more "Total Force" units that mix Reserve and Regular personnel in this way. This implies that rank prerequisites in the Reserves must be consistent with those in the Regular Force.

18.72 Our audit focussed on Class A Reservists in Maritime Command, Mobile Command and Communication Command. As was the case for many other human resource management policies, we found that promotion policies were not directly related to operational requirements. They did not define what is expected at each Reserve rank level or how Reserve operational requirements at each level relate to those of the Regular Force.

We also found systemic weaknesses in the two key criteria used to establish readiness for promotion: Qualification Levels and time in rank.

18.73 We also found systemic weaknesses in the two key criteria used to establish readiness for promotion: Qualification Levels and time in rank.

18.74 Our audit of Qualification Levels indicated that there are serious deficiencies in the definitions of minimum requirements for tasks, skills and knowledge at each rank level. There were inconsistencies in the specifications for common tasks among Regular Force, Reserve and Mobilization (minimum emergency) occupations. In addition, as the section on training shows, we found that training standards often were neither based on nor consistent with occupational specifications; the training delivered diverged seriously from the standards, as did training time. In the combat arms, although the standards state that 215 days of training are required to meet the Basic Qualification Level to mobilization standards for essential wartime tasks, the actual training received in the Militia is 80 days. The training deficit increases as higher rank is attained. Due to these inconsistencies and departures from standards, it is our opinion that Qualification Levels at present do not provide an adequate yardstick to assess readiness for promotion.

18.75 Time in rank is the second key criterion used to assess readiness for promotion. Time in rank standards establish the number of years of service a member must have to be eligible for promotion to the next rank. We found that time in rank standards, as currently applied, do not result in a uniform requirement for experience within the Reserves, and are not consistent with Regular Force operational standards. This is because the standard measures time in rank in calendar years, rather than in service performed. A Reservist serving the minimum 14 days in a year can therefore receive the same credit as a Reservist on a lengthy call–out of 200 days. Moreover, the use of calendar time as the standard provides no incentive for attendance at training or exercises.

18.76 We also assessed Reservists' actual operational experience and found that most individuals promoted in 1990 had received little exercise or field experience in their previous rank (see Exhibit 18.3).

18.77 A Reservist's experience deficit amounts to about 750 days by the time a combat arms officer reaches the rank of Major (see Exhibit 18.4). On the average, it would take over 20 years of Reserve service to equal Regular Force experience at that rank, rather than the average 6.1 years actually attained by Reservists. Although the Department has recognized that the narrower scope of Reserve jobs means Reservists may require less experience in them than Regular Force members, it has not determined how much experience they do require.

18.78 We also examined whether the minimum time in rank was applied consistently, according to policy. Of the 2,177 individuals — ranking from Corporal to Lieutenant-Colonel — who were promoted in the Naval Reserve, Militia and Communication Reserve in 1990–91, 508 promotions (23 percent) did not meet the requirements of even calendar time in rank.

18.79 There is doubt among Reservists as to whether the existing system identifies the best qualified individuals, possibly due to the weaknesses we identified. Our survey of Reservists indicated that, of the respondents, 50 percent in the Militia, 44 percent in the Naval Reserve and 39 percent in the Communication Reserve believe the present system does not always, or even most of the time, promote the best people.

Civilian skills should be better recognized

18.80 Reservists possess a range of civilian skills and qualifications that are often similar to skills required by the military. Although there are systems in place for granting equivalencies, they are ineffective. In 1989–90, among more than 1,200 individuals recruited in occupations where equivalencies exist, the Department granted fewer than 50 equivalencies.

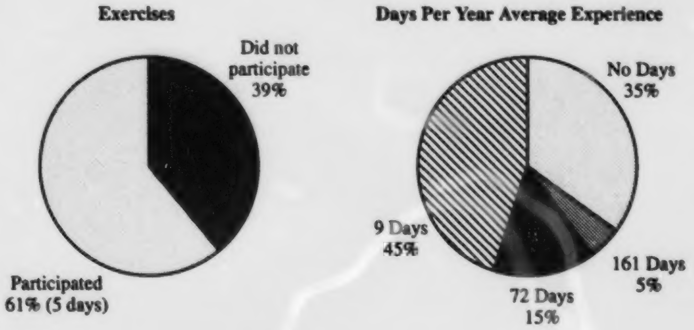
Compensation analysis requires review

18.81 The Department of National Defence has long been aware that Reserve compensation is not in step with that of the Regular Force; inequities have been created that officials believe affect both recruitment and retention. The Department conducted a major study in 1985 that confirmed these inequities, and reported many of them to Parliament during hearings on the 1987 White Paper.

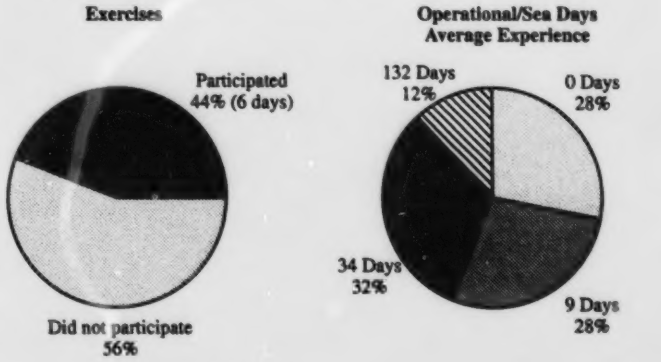
Exhibit 18.3

Operational Experience During Time in Their Previous Rank of Those Promoted in 1990

Militia and Communication Reservists



Naval Reservists



Training must accurately reflect the specific operational requirements of a military occupation, and standards must be enforced to ensure that all members holding similar qualifications can perform to a basic minimum level.

18.82 In an October 1987 memorandum to the Joint Treasury Board Canada/Department of National Defence Advisory Group on Military Compensation, departmental officials pointed to the need to attract and retain members of an expanding Reserve Force as the goal of revising Reserve Force pay. To achieve this, they stated, the "principle of equal pay for equal work" must be applied.

18.83 At the time of our audit, the Department had not made a formal submission to the Treasury Board regarding compensation. We reviewed proposals it had made for pay adjustment and found that the study on which they were based had not attempted to assess the effects of the recommended adjustments on attraction and retention, although problems with both had been the original motivation for pay adjustments. We also found that the Department had used draft Reserve documentation, not yet formally approved, for some occupational comparisons. Some testing of the comparisons obtained was done in those occupations with public service counterparts; however, field validation had not been done.

18.84 In our opinion, given the problems we have identified in the documentation used in the comparability analysis and, for several Commands, deficiencies in the areas of qualifications, experience requirements and expected roles of Reservists, further validation of comparability and analysis of attraction, retention and motivation are needed. Departmental officials told us that this will be done, and that rather than delay needed changes, they will move incrementally toward comparability over the next several years, simultaneously monitoring achievement of standards and attraction, motivation and retention goals.

The largest Reserve components need to maintain training standards

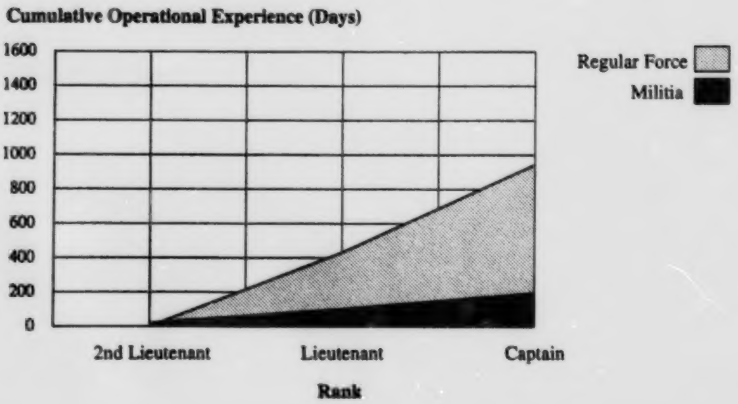
18.85 Proper training in peacetime is the foundation of military capability. Training must accurately reflect the specific operational requirements of a military occupation, and standards must be enforced to ensure that all members holding similar qualifications can perform to a basic minimum level. It is essential that anyone certified as having a skill can perform it, and that any shortfalls between acquired training and battlefield requirements are known so that they can be made up before an individual is sent into combat. The enforcement of training standards is also important to ensure that training effort is not being wasted by delivering inappropriate skills, or proper skills but at higher or lower levels than needed.

18.86 Under the Total Force concept, the Canadian Forces have established the principle that Regular and Reserve Force members should be trained to the same standard, where occupational specifications and tasks are the same.

18.87 We based our audit of training on principles used in the systems approach to training. The Department of National Defence recognizes these principles in the Canadian Forces Individual Training Policy. According to

Exhibit 18.4

Militia Officers Have Less Experience Than Regular Force Counterparts



this policy, the "performance objectives", or minimum acceptable standards of performance, that form the backbone of course training standards must be developed from tasks included in occupational specifications. From these performance objectives, training managers develop course training plans, timetables, tests and examinations, and course reports. Course reporting confirms the candidates' qualifications. Training standards groups monitor the quality of training delivered.

18.88 The Individual Training Policy also requires that training be "validated" or checked against specific operational requirements. This is the ultimate assessment of whether the system delivers the correct training.

18.89 Our audit examined individual training delivered to the two largest Reserve components — the Naval Reserve and the Militia. We based our audit on a representative sample of 14 Naval Reserve courses and 26 Militia courses. Our sample was selected from about 75 percent of the training delivered to these two groups, but excluded training given at Reserve units.

18.90 We also examined professional development courses for officers by reviewing the standards for the STAR I and STAR II courses at the Canadian Forces Command and Staff College in Toronto, and the Militia Command and Staff Course at Kingston. The STAR courses are obligatory for command and staff appointments in the Air Reserve; Naval Reserve officers also attend. The Militia Command and Staff Course is obligatory for promotion to the rank of Lieutenant–Colonel, and command of a Militia unit.

18.91 We found that 93 percent of the Naval Reserve courses should not have granted qualifications to any student, because performance objectives for skill and knowledge required by the occupation did not exist, were not taught or were not tested according to course standards. In some cases, deficiencies were due to a lack of training equipment. We also noted cases where there were insufficient or unqualified instructors. None of the course reports, however, showed that candidates had not met performance objectives.

Many Reserve courses should not have granted qualifications to any student, because performance objectives did not exist, were not taught or were not tested according to course standards.

18.92 Militia courses delivered by Mobile Command suffered from the same type of quality control problems. Eighty–five percent of Militia courses should not have granted qualifications, due to defects in course delivery or testing. In addition, we found marking and examination errors in Militia exams, which showed that 10 percent of students did not receive a passing grade rather than the 5 percent recorded as having failed. Militia course reports for 77 percent of the courses did not show where candidates failed to meet performance objectives.

18.93 We found many cases of failure to maintain the link between occupational specifications and training, in both the Naval Reserve and the Militia. In addition, training courses have not been delivered uniformly from site to site. One of three pairs of Naval Reserve courses and five of seven pairs of Militia courses we examined that are taught at different sites differed so much in performance objectives, standards to be achieved, conditions under which the task was to be done and duration of training that we concluded that the courses were not equivalent.

18.94 The Department has not validated any Naval Reserve or Militia courses against actual sea or field requirements.

18.95 Professional development courses for officers met marking and reporting requirements. However, both the STAR courses, used to prepare Naval and Air Reserve officers for senior positions, and the Militia Command and Staff Course are so much shorter than the comparable Regular Force course that the professional equivalence of Reserve rank must be questioned.

18.96 In addition, Canadian Forces policy is that Regular and Reserve Forces be trained to the same standard when they are expected to do the same tasks. Our audit shows that this is not occurring in the Naval Reserve and the Militia. The differences between Regular and Reserve training are not being analyzed and recorded. Consequently, it is impossible to say what amount of additional training Reservists would require to perform at Regular Force levels.

Opportunities exist to improve the efficiency of training

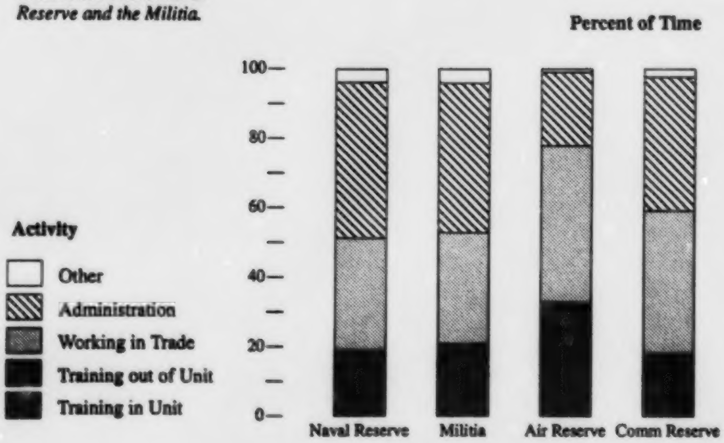
18.97 Reserve training may take place either within the unit or at a training establishment or school. Neither approach is now functioning efficiently.

18.98 Officials told us that the Reserve units are, in fact, "infrastructure" intended to train Reserve members. The Naval and Communication Reserves explicitly recognize this. Reservists told us, however, that the proportion of their time at the unit that is devoted to training or trade–related work is low (see Exhibit 18.5).

Exhibit 18.5

Use of Reserve Time

The proportion of time spent on training and trade–related work is low in the Naval Reserve and the Militia.



18.99 We also found that units in our sample lacked equipment for training. For example, Naval Reserve units are entitled to little, if any, equipment related to operations or operational training. Over 60 percent of the Militia units we audited reported that not enough ammunition was available to complete training requirements. The Militia also lacked enough vehicles and radios to conduct training. Air and Communication Reserve units reported a lack of vehicles as well. Entitlements to equipment were far below those of a Regular Force unit of the same size (see Exhibit 18.6).

18.100 Courses delivered by training establishments do not meet departmental standards of efficiency. The Canadian Forces specifies both the minimum and the maximum number of students for a course to be run efficiently and effectively. We found that 39 percent of Reserve courses are either over– or under–enrolled. This is because the training delivery system is not flexible enough to meet the needs of Reservists, whose availability depends on family, educational and job obligations. Courses must accommodate them, and may therefore have higher or lower than optimum enrolment. Greater use of individualized self–paced training could reduce this problem.

18.101 Our audit also examined the amount of time spent on instruction during the delivery of a course. Courses always spend some time on administration, sports, parades and other non–instructional activities. If training managers divert too much time to those activities, the quality of training may suffer.

18.102 We reviewed courses delivered to the Naval Reserve and the Militia. Although the course standards allowed no time for non–instructional activities, on average 20 percent of course time was spent on them.

18.103 The Department should ensure that Reserve establishments, rank structures and occupational structures and specifications are based on operational requirements, and are realistic and achievable. Variances from Regular Force structures and specifications should be documented.

Department's response: Concur. Establishments are being prepared to reflect the Total Force structure. The Reserve occupational structure and occupational specifications will be reviewed for realism and achievability.

18.104 The Department should improve its ability to attract, motivate and retain Reservists by better targeting of recruiting and by informing recruits of its expectations; by devising and implementing promotion criteria for individuals, appropriate to Reserve service; and by linking pay to attraction, motivation and retention, as well as validating the comparability between the Regular and Reserve Force in a Total Force.

Department's response: Concur. Recruiting procedures, personnel policies, and compensation and benefits for reservists, along with standards, are being monitored and reviewed with a view to equity, attracting desired recruits and personnel from other components of the Forces, and motivating and retaining active members.

18.105 The Department should ensure that its training standards are realistic and achievable by Reservists, and are rigorously enforced and accurately reported.

Department's response: The review of the Canadian Forces Integrated Occupational Specifications will continue, with special attention to operational requirements, achievability under part–time training conditions, and full–time training required prior to operations. Improved Reserve course training standards will result.

Naval Reserve standards cells, and land force area training centres, detachments, and battle schools, are being established. A Total Force standards squadron now exists at the Canadian Forces School of Communications and Electronics.

The responsibilities of the Canadian Forces Training System in support of Reserve training will be assessed.

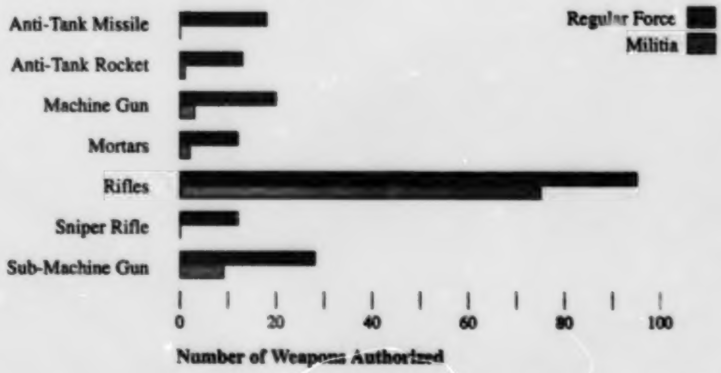
18.106 The Department should validate Reserve training to ensure that it is matched to operational requirements. Priority should be given to validating training for occupations that have no Regular Force equivalent.

Department's response: Concur. Validation of individual training courses will be complemented by operational effectiveness reporting.

18.107 The Department should improve training efficiency by reassessing the role, organization and equipment of individual units for training, by doing more individualized training, and by reducing

Exhibit 18.6

Materiel Entitlement – Land Forces
Regular Versus Reserve Units of a Similar Size



We noted a general problem in acquiring the necessary equipment and facilities within the departmental budget, and in relating the resources acquired to defined requirements.

non-instructional time in courses to the levels specified in standards.

Department's response: *Force development processes and mobilization and contingency planning, coupled with occupational structure and specification reviews and adjustments to operational effectiveness reporting, will improve training efficiency by identifying areas of best return for Reserve training expenditures.*

Full–time support and administrative streamlining will continue to be pursued in order to reduce the proportion of reservists' time required for administration.

Measures such as enhancement of support to the National Employer Support Committee; adjustments to compensation, benefits, and terms and conditions of service; and improvements in the quality of training will continue in order to improve levels and predictability of voluntary attendance.

Ongoing efforts by Commands to grant equivalencies and to develop alternate methods to deliver training will continue.

Over time, the resources devoted to training will be adjusted to optimize their distribution between a smaller Regular Force and a larger Reserve with its special seasonal and geographical training requirements.

Infrastructure Could Be Managed More Economically and Efficiently

18.108 As well as people, armed forces require equipment and facilities to carry out training and operations. Just as the lack of an overall plan has created difficulties for the Reserves in defining and developing human resources, we noted similar problems with infrastructure. Specifically, we noted a general problem in acquiring the necessary equipment and facilities within the departmental budget, and in relating the resources acquired to defined requirements.

Capital Equipment

18.109 Our audit of equipment acquisition focussed on the identification and planning phases. Our objective was to determine the procurement system's ability to deliver to the Reserves the right equipment, in the right place, at the right time, and at the right price.

18.110 We reviewed the equipment levels of the Land Force, both Regular and Reserve. We also examined major equipment projects that were primarily Reserve–oriented:

- the Naval Reserve Minecountermeasures Project and associated projects;
- the Militia Light Armoured Vehicle Project;
- the Air Reserve Kiowa helicopter; and
- the Communication Reserve Electronic Warfare Project.

18.111 We found two major problems: equipment deficiencies persist although revitalization plans include a number of projects designed to overcome them; and some projects have

The Air Reserve has received new aircraft like the DASH–8 (see paragraph 18.112).

incurred additional costs because of errors in project planning.

Equipment deficiencies persist

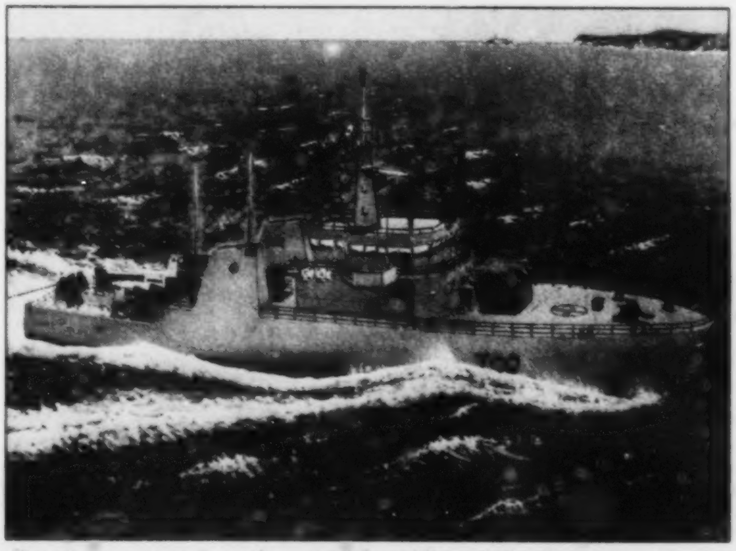
18.112 Most reviews of the Reserves, including the 1989 Senate report on Land Forces, have noted significant deficiencies in equipment. The Department has begun several major projects, such as the Maritime Coastal Defence Vessel (MCDV), the Militia Light Armoured Vehicle, and the acquisition of DASH–8 transport aircraft flown by Reservists for the Canadian Forces School of Air Navigation. The Department has planned several more major Reserve–oriented projects and has stated its intent to redirect resources to address equipment deficiencies throughout the Canadian Forces.

18.113 There is no intent, however, to equip the bulk of the Militia for operations. Current plans for the Total Force army call for equipping less than 30 percent of the Militia for operations as "manoeuvre troops". The rest of the Militia, which will form the basis of the army's less ready "deployment troops", would be equipped with significantly reduced levels of equipment required for individual training at armouries, and with shared sets of equipment at the Militia Training and Support Centres. If large numbers of Militia had to be deployed, training might have to cease. Departmental officials estimated that, although there would be sufficient trucks and jeeps to equip the Total Force army under this plan, there would be shortages of tracked vehicles. In view of ongoing force development planning, officials were unable to accurately quantify the requirement for any other major categories of equipment at this time.

18.114 We also found that funding constraints compromised the capability of new equipment. Two projects that we examined, the minecountermeasures vessel (MCDV) and the Kiowa helicopter, did not deliver the full capability needed to meet the Canadian Forces' requirement.

18.115 For the MCDV, the Department has decided to buy 12 conventional, steel–hulled ships to be the primary training and operational ship for the Naval Reserves. At the time of our audit, the Department had selected a prime contractor but had not yet let the final contract. We examined the planning phase and options analysis for this project. The Department carried out an adequate needs analysis, and fully analyzed the options for meeting the needs as well as the vessel options presented by the bidding firms.

18.116 Due to budget constraints, the system being purchased will not completely meet the stated requirement. Most mines can be triggered by the magnetic field around a steel ship. The MCDV is designed to operate with a remote–operated vehicle (ROV) that can "swim ahead" of the ship to find mines before they explode. This ROV is not affordable now. Officials told us that, in spite of this deficiency, the vessels will be able to perform their role in deep water. They also told us that ROVs could be purchased as part of another project that is scheduled to be undertaken between 1997 and 2003,



New minecountermeasure vessels were well planned, but critical equipment was not affordable (see paragraphs 18.115 and 18.116).

but for which they had not yet drafted a Statement of Requirement.

18.117 The second project we examined is the Kiowa helicopter. The Reserve Wings must train on aircraft that will enable them to conduct wartime operations. The best aircraft to buy for the Reserves are transport helicopters because that is the role most suited to the Reserves' limited availability for training. But budget restrictions forced the transfer of the Kiowa light observation helicopter to the Reserves instead. Since 1981, it has been the aircraft flown by Reserve Tactical Air Wings.

18.118 The Department originally intended that the Reserve Tactical Air Wings would perform all light observation helicopter tasks, but the role of the Reserve Wings was later reduced because Reserve pilots lacked the time to train in the type of flying required to do reconnaissance work. The Kiowas are too small to perform a transport role and lack sensors, laser designators and sights, electronic warfare equipment and chemical/biological protection. Officials do not believe these deficiencies could be made up in time to allow for additional aircrew training before deployment. The Department expects these deficiencies to be corrected by 1998 with the acquisition of the Bell 412 utility helicopter.

The operationally limited Kiowa will be in service until 1998 (see paragraph 18.118).

Some projects incurred extra costs

18.119 Planning errors were made when the Department attempted to complete projects quickly, either to respond to the Minister's direction or to meet defence industry objectives. For example:

- The Department bought two used offshore supply vessels for approximately $10 million. This was in response to the Minister's request in late 1987 that Naval Reservists be provided with the means to commence minecountermeasures training by that summer. Although officials sponsoring the project told the approving authorities that the vessels were "in excellent condition" based on an initial survey, an additional $16 million was needed for unplanned repairs and each vessel was out of service for almost a year.
- In response to the same request by the Minister, in 1988 the Department bought a towed remote–operated vehicle (ROV) for $955,000, to train Reservists in minehunting technology and maritime route survey operations. The ROV was not adequately evaluated before purchase and proved to be too complex for the intended use. At the time of our audit, total costs had escalated to over $2 million, not including unplanned costs for facilities and development of a training package. Officials told us that all deficiencies were being corrected and that a full training program would begin in the summer of 1992.
- The Department purchased 199 Bison armoured vehicles and 22 specialized M113 armoured vehicles required to meet Militia needs for $161 million, before there were maintenance personnel and facilities available to service them. This decision was taken because the manufacturer of the

Bison told the government that, without an immediate order, it could be forced to close its facility and future foreign sales and Canadian production capability would be lost. The result of this decision is that the Department will have many more armoured vehicles than it can service and use until April 1993, when support personnel are to be in place. We estimate that the Department incurred about $17 million in avoidable interest payments by purchasing Bison vehicles before they could be supported.

18.120 We found, however, that the Reserve Electronic Warfare project was adequately planned.

18.121 The Department should ensure that Reserve equipment programs are based on an affordable, long–term force structure plan.

Department's response: *Concur. Procedures are in place to ensure an affordable long–term structure. Capital acquisitions and equipment flow are carefully addressed in the force development process and the Defence Program Management System. These and other functions, in concert with the fifteen–year Canadian Forces Development Plan recently issued, ensure that requirements and acquisitions match equipment suitability and capability.*

18.122 The Department should ensure that its project screening and assessment practices conform to its policies.

Department's response: *Concur.*

Facilities

18.123 The Reserves require an extensive network of facilities to support their operations. The 202 Reserve units are housed in 139 stand–alone buildings across the country, and in other facilities such as hangars on Canadian Forces bases. In addition to these buildings, the Reserves need specialized facilities that can provide an appropriate environment to house and operate equipment not normally available at a unit. Naval Reserve facilities are found at Fleet Schools shared with the Regular Force. The Air Reserve also takes advantage of shared facilities at Air Command Bases and at the Air Reserve Training Centres. The Militia and the Communication Reserve require extensive tracts of land on which to train. They routinely use Regular Force ranges and exercise

Minesweeper auxiliary vessels cost $16 million more than was anticipated (see paragraph 18.119).

199 vehicles were purchased without expanding service support necessary to their use (see paragraph 18.119).

areas such as CFB Gagetown. In addition, Mobile Command is constructing a Militia Training and Support Centre at Meaford, Ontario.

18.124 All Defence facilities are now under review. In his September 1991 policy statement, the Minister announced the formation of a Task Force to establish principles for reviewing the present inventory of properties. The March 1992 Budget statement by the Minister of Finance announced the government's intention to review all urban infrastructure owned by the Department of National Defence.

18.125 The Department has a large portfolio of new construction projects under way for the Reserves. At the time of our audit, this included the $106 million Militia Training and Support Centre at Meaford, the Naval Reserve Training Centre in Quebec with an estimated initial cost of $36 million, and 21 armoury replacement projects totalling $138 million (1989–90 dollars).

18.126 Our audit examined:

- one major facility construction project from each Command;
- seven projects chosen at random from unit building replacement projects over the last eight years; and
- one project chosen at random from new facilities at Sept Isles, Charlottetown, and London.

A strategic plan for facilities is required

18.127 We found that the Department lacks a strategic plan for Reserve facilities that takes into account force development, available funds, the need to rationalize facilities, differing Command requirements and Reserve membership characteristics. The Department has constructed facilities that have not been justified by operational requirements, facilities that are much larger than their actual use requires, and facilities for which site selection is questionable. The Department has taken initiatives, such as the use of standard armoury designs that officials estimate reduce the cost of individual armouries by $1 million. However, problems exist in overall planning for Reserves that lead to problems with Reserve facilities.

- Although Mobile Command does not know the number and type of Militia units it requires and does not have a rationale for existing Militia units, facilities replacement has gone ahead. The Department has spent over $40 million to replace armouries in the last nine years and has identified another 32 projects worth over $251 million (1989–90 dollars).
- The Department constructs Militia armouries according to the "establishment" of the unit, resulting in buildings much larger than required to meet recent use. As we indicated earlier, Reserve establishments are out–of–date and under review. They show unit strengths that are much higher than the number of people at the units. From May 1989 to June 1991, the total effective strength of the Militia averaged less than 40 percent of its establishment. Actual turnout was only half the effective strength.
- The Department is building three new Naval Reserve Divisions at Sept Isles, Charlottetown and London at a cost of about $40 million to provide facilities for growth approved in the 1987 White Paper. Officials did not adequately assess less expensive alternatives, such as adding a few additional Reservists to each existing Division, or the possibility of building a single, large unit to accommodate all the growth.
- The Department has not analyzed how population demographics relate to unit sites. Documents refer to "depleted" recruiting basins in

the heart of Canada's cities, but in Toronto, for example, we found there were large numbers of 20– to 24–year–old males living close to existing facilities. Only two of the seven replacement projects we audited had studied the unit's demographics, and in no cases were data on the unit's community evaluated in terms of the recruiting possibilities. Determining the best site for an armoury always involves some judgment by Forces staff. The Department, however, has not provided an adequate analytical framework in which to make this judgment.

- The Department located Naval Reserve Divisions in Rimouski, Chicoutimi and Trois–Rivières as part of the "Naval Presence in Quebec" project, without any detailed analysis of recruiting potential. Although the Department concluded that all the units could recruit a full 200–member Division by 1990–91, at the time of our audit two of the units had reached only 52 and 62 percent of their establishments, short of even their adjusted target of 79 percent. Departmental analysis shows that, in at least one community, young people are moving away due a shortage of educational and job opportunities.

- The Department has not located the Air Reserve Training Centre on a base capable of supporting its rapid growth, nor has it been able to identify a suitable base for the future because of uncertainties in force structure planning and the lack of integration between force and facility planning in the Department.

Facility requirements need to be met more quickly and more completely

18.128 We reviewed the length of time it takes the Department to satisfy requirements for Reserve facilities. We found it takes about 15 years to fund a project, and then an additional six years to build it.

18.129 We also found that facilities are deficient overall. Officials were well aware of deficiencies, but told us that budget limitations and lack of available land precluded a solution. For example:

- the planned $106 million Militia Training Support Centre in Meaford will be about half the size necessary to support training requirements, according to the Department's Range and Training Area Development Plan;

- only 2 percent of Militia units have the required access to training areas, and 30 percent have no access within normal travel time to adequate collective training areas of any type. Land may not be available to eliminate the deficiencies;

- 48 percent of Naval Reserve facilities do not meet minimum military guidelines; and

- the Militia and the Communication Reserve have identified 44 major armoury replacements that are needed, roughly a third of the existing buildings.

18.130 This shortfall again emphasizes the critical deficiency in resources available to meet operational requirements, and the need to define an affordable force structure. It also confirms the need to pursue the most cost–effective options in meeting infrastructure needs. Total Force plans are aimed at increasing the size of the Reserves, especially the Militia, and more fully integrating them with the Regular Force. There is therefore a need to provide adequate training. If shortages of training facilities persist over the long run, it will be necessary to find alternative means of training or to adjust standards of readiness.

The Department has constructed facilities that have not been justified by operational requirements, facilities that are much larger than their actual use requires, and facilities for which site selection is questionable.

18.131 The Department should develop a strategic plan for facilities as an integral part of its long-term force development plans. This plan should be all-encompassing, based on a complete review of existing facilities and a thorough analysis of other factors such as demographics, recruiting and retention history, and economics. It should take into account the need to optimize the use of suitable infrastructure by the appropriate combining of units and sub-units to permit the disposal of facilities in poor condition, the optimum use of suitable facilities, and the creation of new facilities based on force structure needs and other national factors.

Department's response: *The Department uses the same basic process suggested in the recommendation. The Canadian Forces Development Plan, and departmental infrastructure activities, will put in place the mechanism to prepare a strategic facilities plan. Special efforts will continue to address the particular requirements of the Reserve, including demographics, recruiting, retention, and the minimization of travel time.*

The Current Capability Level of Reserve Components Needs to Be Reviewed

Primary Reserve readiness is low

18.132 There is no absolute standard of readiness for a country's Reserve force. The state of readiness at which a government holds its forces depends on its appreciation of the military threat and the resources available to meet it. We expected that senior headquarters would have defined standards of readiness and communicated them to all units. We also expected that readiness standards for the Reserves would be lower than those of the Regular Force.

18.133 However, the Canadian Forces has not established readiness goals for most of its Reserve Forces. National Defence has not rescinded the Canadian Forces Readiness and Sustainment Policy, issued in 1985, which officials consider obsolete. The policy did not provide guidance on the warning time commanders could assume before the commencement of operations. The present force structure seems to require that part of the Reserves be deployable in less than 30 days, but Commands have not formally communicated this to the units themselves.

The two largest Reserve components — the Naval Reserve and the Militia — cannot currently maintain the performance levels desired by the Commands.

18.134 Commands now rely on a variety of performance measures to assess Reserve readiness. We found, however, that the two largest Reserve components — the Naval Reserve and the Militia — cannot currently maintain the performance levels desired by the Commands. They are affected by the factors described in previous sections of this chapter, including unclear roles, low turnout of personnel, and equipment shortages.

18.135 The Naval Reserve Combat Readiness Reporting System shows that only one-quarter of the time do individual divisions achieve Combat Readiness Scores exceeding 50 percent for any of their assigned tasks. Maritime Command officials attributed low performance to attrition, turnout difficulties, and equipment deficiencies and noted that the acquisition of new equipment would improve the situation. They also told us that performance below standard was acceptable since they expected to have warning time during which teams could be brought to standard. We found, however, that current standards do not state how much time would be required or what warning time is anticipated.

18.136 Militia units lack performance standards. However, periodic exercises and staff assessments show that the level of Militia training is very low and that the Militia cannot conduct field operations above the sub-unit level. Training System staff estimated that a large proportion of Militia members would have to redo basic occupational training before deployment, though trainers had considered them qualified.

18.137 Poor turnout affects both the Naval Reserve and the Militia. The inability to achieve a 30 percent turnout target for exercises from 1988 to 1990 has directly affected the peacetime effectiveness of the Naval Reserve. On average, both Naval Reserve and Militia Commanding Officers estimate that less than half their Reservists would turn out voluntarily for a combat task.

18.138 As we have noted already, Reserve units lack both the training to maintain combat readiness and the equipment required for field operations.

18.139 The Air Reserve is more ready than either the Naval Reserve or the Militia. It can maintain the flying qualifications of the required number of pilots, although these pilots may be under flying restrictions that would affect operational employment. At the time of our audit, the two largest Air Reserve units, 1 and 2 Tactical Air Wings, which together amount to about 25 percent of the total strength of the Air Reserve, lacked an approved organization or role. This prevented them from having an entitlement to equipment that would allow them to deploy tactically. The Department approved an organization for these units in late 1991. Air Reserve exercise reports show that Reserve personnel are not always available due to civilian job demands. Commanding Officers told us that less than two–thirds would turn out for a combat task. However, recent experience indicates that when requirements can be met by allowing Reservists to be employed using part–time job sharing, as was done during the Oka crisis, or when only small numbers of Reservists are needed as was the case during the Gulf War, sufficient Air Reserve personnel have been available.

18.140 We found few serious deficiencies in Communication Reserve readiness, although officials have noted problems with training levels, equipment shortages, and training realism.

18.141 The Department should continue to adjust roles, training and equipment so that the Reserves can reach a prescribed level of readiness that can be shown to be a cost–effective use of defence resources.

Department's response: *Concur. Note responses to paragraphs 18.48 and 18.107.*

The Supplementary Ready Reserve has increased in size, but is not matched to Force requirements

18.142 The Supplementary Ready Reserve (SRR) is a sub–component of the Reserve Force, made up of former members of either the Regular Force or the Reserves, or of individuals without military experience but with special skills for which there is a military need. The primary purpose of the SRR is to augment the Canadian Forces with previously trained personnel in times of national emergency or mobilization. It has a secondary role of augmenting the Canadian Forces in peacetime, when required.

18.143 At the time of our audit the target strength of the Supplementary Ready Reserve was about 16,000 members, costing the Department about $8 million annually to pay and administer. Administrative costs consume about 60 percent of the SRR budget.

18.144 Our audit consisted of reviewing the personnel files of the 8,173 members of the SRR who were on the Department's central computer database in October 1991. We found that:

- over 43 percent did not meet the Department's military currency requirements, in that they had not trained or re–qualified for their occupation in over five years;

- although Ready Reservists are required to be medically fit, no medical information is available on the most recent SRR database. In January 1991, over 50 percent of those with medical data on their records had last been certified more than five years before our audit; and

- program managers make no attempt to screen out, or otherwise manage, applicants who might not be available to the Canadian Forces in an emergency because their civilian employment would be considered essential. Of the 4,504 files that listed a civilian occupation, 16 percent were employed either in an essential service job or by National Defence itself.

18.145 We also found that the Department is unable to apply the central management concept behind the Supplementary Ready Reserve — that individuals would be recruited against requirements of individual positions identified in the War Establishment — because no approved War Establishment exists. The Department is therefore recruiting Ready Reservists into "pools" that lack occupational and rank criteria. Departmental officials could not say to what extent SRR members would match actual requirements.

18.146 In our opinion the SRR is not effectively screening entrants, maintaining training, or separating those unable to remain current. Value for money is not being attained.

18.147 The Supplementary Ready Reserve concept should be re–examined and validated. The Department should ensure that those enrolled are current in required skills, are medically fit, are available for service and are in an appropriate occupation and rank.

Department's response: *Concur.*

Accountability for Performance Needs to Be Improved

Internal accountability is weak

18.148 We found that internal performance management systems are weak or non–existent. We reviewed the Reserve readiness reporting systems maintained by the Commands to determine the extent to which they had assigned clear, realistic, measurable and attainable tasks to each Reserve unit. We also examined whether they had put systems in place to monitor and regularly measure organizational deficiencies and performance. In the three largest Reserve components we found serious deficiencies in performance reporting. Mobile Command, in particular, does not know how many Militia soldiers would be ready for deployment, how many sub–units it could depend on, or what their level of training really is.

18.149 The Communication Reserve is almost completely integrated with the Regular Force and does not have, or require, a separate reporting system for its units.

Management responsibility is diffused

18.150 Throughout our audit, we noted that existing management systems are not designed to allow managers to make trade–offs in the interest of overall cost–effectiveness. Separate allocations are made for the numbers of Regular Force personnel, the numbers of Reserves, capital equipment and facilities. This appears to have created incentives to get the maximum possible of each resource type, rather than to get the best mix. Some Commands, for example, are continuing to increase the number of Reserves although equipment for them is not yet available. Plans to upgrade armouries are proceeding, despite the recognized need to carry out a fundamental review of the numbers and types of units needed.

Because information is inadequate, it is unlikely that the best mix can be determined.

18.151 What is needed is a way to provide an operational, performance–oriented perspective to major management processes, including those related to the Reserves. The Ministry of Defence in the United Kingdom has fully implemented a "shadow budgeting" system to provide its senior military commanders with resource information linked to operational performance. National Defence is itself experimenting with a similar system on two Canadian Forces bases, so far with positive results. This concept is consistent with the underlying theme of Public Service 2000, that managers should be allowed to manage and should be given the tools to make decisions. We believe that this approach should be expanded as broadly as possible within the Department and the Canadian Forces.

Parliament should be better informed

18.152 The Department provides information to Parliament through Part III of the Estimates and through testimony to parliamentary committees.

18.153 Treasury Board policy states that each Part III shall provide enough information to help Members of Parliament understand and assess a program's planned and actual performance in terms of results and related resources. Part IIIs are to contain key indicators of performance for each activity, the performance of the activity with respect to such indicators, and a justification of the amount and type of resources required.

18.154 Many of our prior Reports have contained references to deficiencies in the Part IIIs. In 1988 we recommended that the Department of National Defence define reporting indicators that would not compromise national security, and a timetable for introducing these indicators into Part IIIs.

18.155 The Department has declined to do this because of "the classified nature of performance indicators" used within the Department. We have observed that classification of data has not deterred the United States Department of Defense from providing Congress with performance information.

18.156 We reviewed Part III of the Estimates, and testimony given since 1987. We found that National Defence provides very little performance information about the Reserves. Part III includes none at all, reporting only gross budgets and the "Paid Ceiling" of each Command, or number of Reservists who could be enrolled if each worked an arbitrary average number of days.

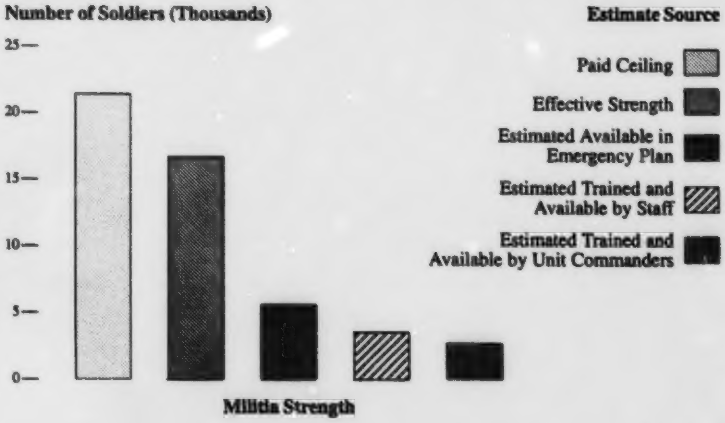
18.157 Paid Ceiling is a poor indicator of the available military manpower. Exhibit 18.7 shows that, for the Militia, Paid Ceiling is much higher than effective strength, trained strength, and the number of Reservists believed to be trained and available.

18.158 The Reserves represent over a third of Canada's military manpower. As our audit has shown, there are severe deficiencies in the readiness of the Naval Reserve and the Militia, and significant deficiencies in the Air

What is needed is a way to provide an operational, performance–oriented perspective to management processes.

Exhibit 18.7

Militia Strength Measures
Comparison of Incumbents/Actual Usable



Reserve. These are of a nature to affect the general performance of the Total Force activities that form the basis of the Part IIIs.

18.159 In our opinion, the situation is unsatisfactory. The Department is providing little meaningful information to Parliament, while increasing its expenditures and its reliance on a component of the Canadian Forces that has undisclosed performance problems.

18.160 Departmental officials told us they are making efforts that, if successful, could result in the inclusion of performance indicators for Reserves in Part III of the Estimates.

18.161 The Department should undertake a general review of organization and accountability to ensure that officials are held responsible for Reserve program performance and are provided with the authority and information required to make necessary decisions.

Department's response: *Implementation of Total Force and restructuring of formations and units, including the land force area structure, are improving the alignment of responsibility and accountability.*

Adjustments to the Operational Readiness and Effectiveness System include Reserves within assigned Total Force taskings.

Efforts will continue, through continued decentralization and other initiatives, to better link activities to resource management for all aspects of the Department, including Reserves.

18.162 The Department should include in Part III of the Main Estimates enough information about the performance of the Reserves to permit Parliament to assess their cost–effectiveness.

Department's response: *At the time the operational plan framework was developed, the Department's management decided with the concurrence of both Treasury Board Secretariat and the Office of the Comptroller General to include Reserves with the associated Regular Force entity rather than to identify them separately. This approach is consistent with the Total Force concept. DND does not intend to report Reserves as a separate activity in Part III Estimates. However, as Total Force and resource management initiatives mature, more detailed data on resources will be readily available. This information will be carefully analyzed by the Department and made available to Parliament in a manner appropriate to Total Force reporting.*

Chapter 19

Department of National Revenue – Customs and Excise

Special Import Measures Act

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Assistant Auditor General: Shahid Minto
Responsible Auditor: Nancy Cheng

Department of National Revenue – Customs and Excise

Special Import Measures Act

Main Points

19.1 The Special Import Measures Act provides a legislative framework to offer remedy to domestic producers against material injury caused by dumped or subsidized goods from other countries. The Department of National Revenue — Customs and Excise is primarily responsible for investigating allegations of dumping or subsidizing causing injury. The Canadian International Trade Tribunal conducts inquiries and makes findings relating to injury.

19.2 The Department has taken reasonable steps in initiating investigations and determining dumping. We observed some areas where the Department should maintain a broader perspective in considering injury during its investigation before making a preliminary determination. Further, there is a technical limitation arising from the legislation that precludes the Department from considering further evidence of injury when a case is referred to the Tribunal for advice at an early stage of the process.

19.3 Undertakings offered by foreign exporters or governments can serve as a less costly alternative to a full–length proceeding. However, they can easily be vetoed and terminated by any interested party, thereby rendering previous negotiations and efforts futile. Moreover, the Department needs to monitor undertakings closely to ensure that violations of their terms and conditions are detected promptly.

19.4 The Department conducted an evaluation study in 1988 and has used the results to improve its administration of the program. The Department of Finance, the department responsible for policy and legislation, has conducted ongoing monitoring of anti–dumping and countervailing cases, but it has not completed a formal evaluation of the program since the Act came into force in 1984. In our view, such evaluation effort is needed to determine if the balance of rights and obligations established in 1984 continues to be appropriate in the present trade environment, particularly in light of the ongoing Uruguay Round of Multilateral Trade Negotiations and the Canada–United States Free Trade Agreement.

Introduction

19.5 The Special Import Measures Act (SIMA) is Canada's codification of anti–dumping and countervail rules resulting from the Tokyo Round of negotiations under the General Agreement on Tariffs and Trade (GATT). It is a significant component of Canada's import trade policy. The Act came into force in December 1984, replacing the Anti–dumping Act and certain provisions in the Customs Tariff concerning countervail. The SIMA program affects Canadian trade and many industries. As of March 1992, existing anti–dumping and countervail cases involved approximately $2 billion of domestic goods and affected over 10,000 jobs.

19.6 The Special Import Measures Act provides a legislative framework to offer remedy to domestic producers against material injury caused by dumped goods by imposing anti–dumping duties or, in the case of subsidized goods, countervailing duties. "Dumping" refers to the selling of foreign goods to Canadian importers at prices lower than their home market prices or their production costs. Injury is often evidenced by a decline in sales, market share or profits; price erosion or suppression; a drop in employment levels; negative growth; and decreased utilization of production capacity. A causal link must be established between dumping or subsidizing and injury before Canadian producers can obtain redress. Canada is one of the major users of anti–dumping measures among GATT signatories; it accounts for only a small percentage of the countervail actions.

19.7 The Department of Finance is responsible for the SIMA policy and legislation. The Department of National Revenue — Customs and Excise and the Canadian International Trade Tribunal (CITT) are jointly responsible for administering the SIMA program.

19.8 The stages in the SIMA process and the related time limits are defined in the Act and summarized in Exhibit 19.1. With few exceptions, the process starts when a domestic producer files a complaint with the Department of National Revenue — Customs and Excise. The Department decides whether to initiate a case and is primarily responsible for investigating and determining whether dumping has occurred and the margin of dumping. The Tribunal is an independent quasi–judicial body acting as an administrative court in findings of injury.

The Special Import Measures Act provides a legislative framework to offer remedy to domestic producers against material injury caused by dumped or subsidized goods.

Audit Scope and Objective

19.9 The audit focussed on the administration of the SIMA program by the Department and the Canadian International Trade Tribunal. We also examined the evaluation of the SIMA program.

19.10 Our audit examined whether appropriate procedures and standards are in place to administer SIMA; and if the program had been evaluated and the results reported. We expected to find departmental systems and procedures to ensure timely and objective administration at the least possible cost to all parties involved.

19.11 We carried out our work mainly at the Assessment Programs Division of the Department's Customs Programs Branch in Ottawa. We also interviewed representatives from the Tribunal and the International Economic Relations Division of the International Trade and Finance Branch in the Department of Finance.

Findings and Observations

19.12 Our major findings are reported in this chapter. Other findings were brought directly to the attention of the Department's senior management. We made observations in three areas —

consideration of injury during investigations; undertakings; and program evaluation.

Consideration of Injury during Investigations

19.13 On the basis of a complaint filed by domestic producers, the Department initiates an investigation only if its preliminary review reveals a reasonable indication of injury resulting from dumping or subsidizing. The Department has up to 90 days to make a preliminary determination or to terminate the investigation due to lack of evidence on injury, dumping or subsidization. Under SIMA, the 90–day period can be extended to 135 days.

19.14 The SIMA legislation represents a legislative framework of Canada's international rights and obligations as negotiated under the Subsidies and Anti–dumping Codes of GATT. In the view of the Department of Finance, the objective of the program is to balance these rights and obligations among all parties involved. The legislation provides a right of recourse for domestic producers against foreign trade practices causing injury, while affording a safeguard to importers and foreign exporters against undue trade harassment.

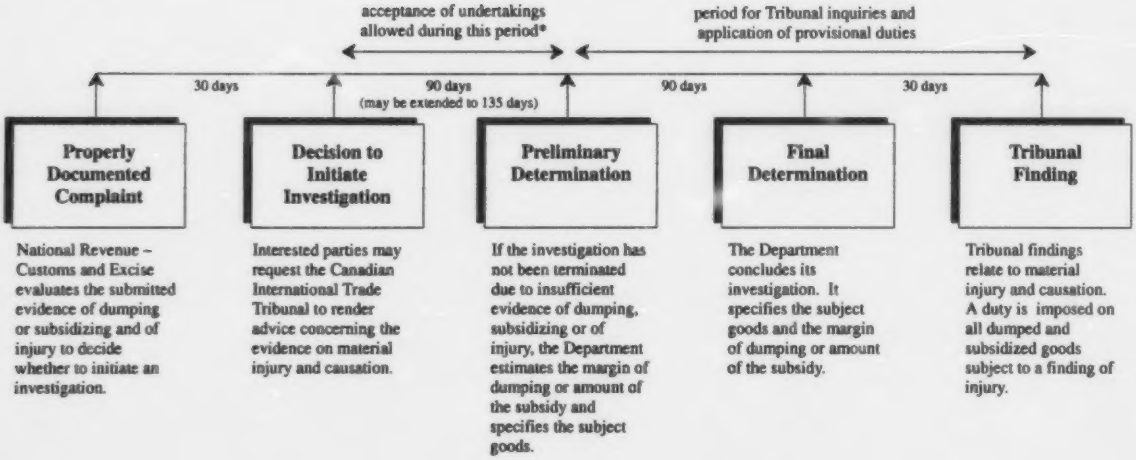
19.15 Exhibit 19.2 shows a summary of SIMA cases from December 1984 to March 1992. The Department of National Revenue — Customs and Excise received 86 properly documented complaints and initiated 77 investigations. Approximately 70 percent of all cases went through the full–length proceeding, including an inquiry by the Tribunal. About a third of the cases heard by the Tribunal ended in a finding of no injury.

There was limited consideration of injury during investigation leading to preliminary determination

19.16 The GATT codes require the evidence of dumping and injury to be considered simultaneously during the investigation phase. Similarly, under SIMA, the Department continues to be responsible for ensuring that there is a reasonable indication of injury before it makes a preliminary determination,

Exhibit 19.1

SIMA Process


acceptance of undertakings allowed during this period*
period for Tribunal inquiries and application of provisional duties
30 days
90 days (may be extended to 135 days)
90 days
30 days
Properly Documented Complaint
Decision to Initiate Investigation
Preliminary Determination
Final Determination
Tribunal Finding

National Revenue – Customs and Excise evaluates the submitted evidence of dumping or subsidizing and of injury to decide whether to initiate an investigation.

Interested parties may request the Canadian International Trade Tribunal to render advice concerning the evidence on material injury and causation.

If the investigation has not been terminated due to insufficient evidence of dumping, subsidizing or of injury, the Department estimates the margin of dumping or amount of the subsidy and specifies the subject goods.

The Department concludes its investigation. It specifies the subject goods and the margin of dumping or amount of the subsidy.

Tribunal findings relate to material injury and causation. A duty is imposed on all dumped and subsidized goods subject to a finding of injury.

** Investigation is suspended following an acceptance of undertakings to raise prices or to eliminate or limit subsidization for exports to Canada.*

unless the case has been referred to the Tribunal for advice.

19.17 We found that the Department has consistently met the legislated time limits in administering SIMA. Although dumping and injury have both been considered during its investigations, the Department has been largely preoccupied with the determination of dumping and the related margins. It has sought evidence almost exclusively on the volume, normal values and export prices of the alleged dumped goods, and done little investigation work on injury. In the case files we reviewed, the Department's consideration of injury was limited to confirming with complainants the information they had supplied.

19.18 The existing GATT codes provide for interested parties to offer opposing views concerning injury throughout the investigation. National Revenue — Customs and Excise and the Department of Finance acknowledge that importers, exporters and foreign governments are not precluded from making representations disputing the claim of material injury. However, we observed that procedures for making representations or submissions have not been established by National Revenue — Customs and Excise.

19.19 While the Department's primary role is the determination of dumping and the related margins, we are of the opinion that the interests of all parties would be better served if the Department maintained a broader perspective in considering injury during investigations.

Referral for Tribunal advice precludes the Department from considering further evidence of injury

19.20 The question of injury can be referred to the Canadian International Trade Tribunal for advice at several early stages of the SIMA process. Sections 33(2) and 34(b) of the Act provide for two of these referrals. Essentially, within specified time limits, interested parties have the right to refer a case to the CITT to determine whether an investigation is warranted on grounds of injury.

19.21 The Tribunal examines the evidence of injury and renders its advice within 30 days of the referral. The evidence available to the Tribunal for this examination is the information filed with the Department by the complainant before the start of the investigation. If CITT advises that the evidence of injury is insufficient, the case is terminated. If it advises that there is a reasonable indication of injury, the Department proceeds with the investigation but is precluded from considering the question of injury further.

19.22 Prior to initiating the investigation, the Department receives information from one party, the complainant. It is in the investigation stage that the Department starts to contact the importers and foreign exporters — the opposing parties. Additional information obtained during this stage could render the previous evidence of injury insufficient. Nevertheless, by virtue of the Tribunal's advice, the Department is still obliged to carry the case through the full proceeding unless it can be terminated on grounds not related to the question of injury.

19.23 Exhibit 19.3 describes a case where, subsequent to the Tribunal's advice, the Department became aware of additional information that could have had a bearing on the complainant's claim of injury, but which it could not pursue. The case ended in a finding of no injury.

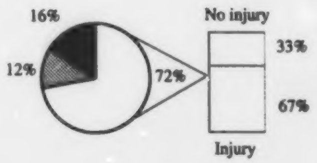
19.24 We found that, since December 1984, the Tribunal has disagreed with the Department in only two of the 32 cases on which it has rendered advice under these provisions. We believe that the high incidence of the Tribunal's upholding the Department's decisions could be due in part to the fact that its examination is restricted to the same evidence the Department has

During its investigations, the Department has been largely preoccupied with the determination of dumping and the related margins.

Exhibit 19.2

Summary of SIMA Investigations
1 December 1984 to 31 March 1992

Total properly documented complaints received	86
Total investigations initiated	77
Investigations in progress	2
Investigations terminated, suspended or subjected to full-length proceeding	75



■ Terminated due to insufficient evidence of injury, dumping or subsidizing

▨ Suspended following the acceptance of undertakings

☐ Full-length proceeding: cases heard by the Canadian International Trade Tribunal before the start of an investigation. Of the 22 cases where the Tribunal advised that there was a reasonable indication of injury and that were subsequently heard by the CITT, eight resulted in findings of no injury or partial injury.

In rendering advice, the Tribunal's examination is restricted to the same evidence the Department has before the start of an investigation.

19.25 Proceeding to a full hearing involves additional time, effort and costs to all parties. In our view, all parties would benefit if the advice resulting from CITT referrals did not preclude the Department from considering any further evidence of injury before making its preliminary determination.

Undertakings

19.26 An undertaking represents an offer from a foreign exporter or government to increase the export price, eliminate the subsidy, or limit the quantity of the subject goods to be exported to Canada, effectively eliminating the injurious effect of dumping or subsidization. If the Department accepts an undertaking, its investigation is suspended. An undertaking is often viewed as an expeditious and less costly alternative to a full-length investigation and Tribunal inquiry.

19.27 Undertakings demand considerable time and effort from the Department as they must satisfy a number of conditions. For example, the undertakings must cover all or substantially all of the allegedly dumped or subsidized goods. They can be accepted only after an investigation is initiated but before the Department makes a preliminary determination. Undertakings have been accepted in approximately 12 percent of all investigations initiated since December 1984.

Undertakings can easily be vetoed and terminated

19.28 Under the Act, the Department is required to terminate an undertaking without cause if requested by a complainant, importer, foreign exporter or government within 30 days after its acceptance. Such termination renders previous negotiations and efforts futile. If an undertaking is terminated, the investigation process resumes and the Department continues to be bound by the legislative time limit to make its preliminary determination.

19.29 We noted that the existing provisions permit any party to become an importer of record and to then veto an undertaking that has been negotiated between the Department and the foreign exporters. Exhibit 19.4 illustrates a case where this was used by a manufacturer to exclude a certain product from the list of subject goods covered by an undertaking. The Department had to change its position and accept the exclusion at the last minute to secure the undertaking. The Department noted that any importer, including small-volume importers, could request that an undertaking be terminated.

Exhibit 19.3

Case: Polyphase Induction Motors Over 200 H.P. from Brazil, France, Japan, Sweden, Taiwan, U.K. and U.S.A.

Date	Event
30 September 1988	The Department initiated investigation and indicated that the complaint was supported by two other domestic producers. Among other effects, the complainant claimed injury in the form of lost sales, loss of market share and price suppression.
2 November 1988	The Tribunal advised that the evidence supported a reasonable indication of material injury.
29 December 1988	The Department made a preliminary determination noting that one of the domestic producers could not support the complaint concerning large motors and that the producer had proposed to include in the complaint only motors up to 1,000 H.P. The Department indicated that such a proposal, if accepted, would exclude a significant value of imports that had been found to have been dumped and subsidized, and that were still claimed to be causing injury. With respect to injury, the Department stated that the Tribunal's advice precluded the Deputy Minister from terminating the investigation for insufficient evidence of injury.
28 April 1989	CITT made a finding of no injury. Among its reasons, the Tribunal noted that a significant portion of the domestic producers' loss of market share in 1987 had been due to imports of motors over 8,000 H.P. from a country not party to the investigation. Their market share had increased in 1988. Consequently, the Tribunal saw no clear evidence of any loss of market share by domestic producers nor a substantial degree of import penetration by any of the subject countries. The Tribunal also found no direct evidence of price suppression, given the customized nature of the motors for each contract and the absence of any meaningful price lists.

19.30 In a case involving subsidized foreign goods, the Department extended the 90–day limit on negotiations and took 131 days to secure an undertaking. After the undertaking had been accepted, the complainant demanded that the quantity of the subject goods be further reduced. The demand was not accepted by the foreign delegation and the undertaking had to be terminated at the complainant's request.

An undertaking is often viewed as an expeditious and less costly alternative to a full–length investigation and Tribunal inquiry.

The Department needs to monitor undertakings closely

19.31 Undertakings require monitoring to ensure that their terms and conditions are respected. Violations of the terms and conditions can cause the undertakings to be terminated. The SIMA provisions permit the Department to apply duties retroactively, but only to 90 days before the notification terminating the undertakings. Consequently, violations can escape duties if not detected promptly.

Violations can escape duties if not detected promptly.

19.32 In the case shown in Exhibit 19.5, undertakings originally accepted in January 1988 were renewed in January 1991. Between January and June 1991, there were shipments of the subject goods at prices below those negotiated in the undertakings. The violation was not detected until September 1991. At that time, the Department terminated the undertakings and had to make its preliminary determination on the same day, using 1987 data. Although anti–dumping duties could be applied retroactively for 90 days, the shipments before 25 June 1991 that had violated the undertakings escaped the duties.

19.33 By its nature, the monitoring of undertakings takes place after the subject goods arrive in Canada. We noted that this monitoring is done only at Headquarters; regional staff are not involved. The enforcement staff at Headquarters scan the Customs commercial database periodically for shipments of goods subject to undertakings, and request the related documents for review. This results in a delay in detecting violations. The Department has begun to address this concern, and indicated in a draft regional handbook that it would introduce monitoring of undertakings by regional officers. As we concluded our audit in March 1992, departmental policy and procedures had yet to be developed.

Program Evaluation

19.34 As the department responsible for SIMA policy and legislation, Finance is responsible for evaluating the overall effects of the program. We would expect Finance to monitor the program on an ongoing basis and conduct periodic evaluations to determine to what extent the program objectives and Canada's international obligations are being met. In its capacity as administrator of the program, we would expect the Department of National Revenue — Customs and Excise to review and report on the operational effectiveness of SIMA.

Exhibit 19.4

Case: Oil and Gas Well Casing from Japan and the Federal Republic of Germany

Date	Event
28 October 1986	One Canadian manufacturer asked the Department to clarify whether a green seamless tube was covered by the investigation initiated on 20 August 1986.
30 October 1986	The Department's position was that the green seamless tube was included in the investigation. However, the manufacturer threatened to import some of these tubes and qualify as an importer of the subject goods, and to request a termination of the undertaking offer. While Finance believed that small volume importers should not be able to circumvent the undertaking process by merely requesting that an undertaking be terminated, the Department held that any importer, however small, could request a termination.
5 November 1986	The manufacturer informed the Department that it was an importer of subject goods. If the green tube were to be included in the undertaking accepted by the Department, it would request in writing that such an undertaking be terminated.
17 November 1986	The Department resolved the situation by excluding the green tube from the subject goods. It noted that such tube would be handled in a separate investigation should the need arise.

Management has used the results of its 1988 study to improve program administration.

The Department has reviewed and reported on the operational effectiveness of SIMA

19.35 The Department undertook an evaluation study in 1988 on the administration of SIMA. The scope of the study included the accessibility to SIMA actions by potential complainants, and the Department's investigation and enforcement activities. In particular, it addressed:

- the disincentives to use SIMA;
- the documentation of complaints and investigations;
- the related departmental policy and procedures;
- the organizational structure and human resources; and
- the level of voluntary compliance by importers.

The study relied on information extracted from a departmental database, interviews with Customs staff, and surveys of complainants, importers, brokers and producers.

19.36 On the basis of our examination of the report and the supporting files, we concluded that the quality of the study is satisfactory.

19.37 We noted that management has used the results of the 1988 study to improve program administration. The Assessment Programs Division prepared an action plan to implement the recommendations in the study and completed quarterly progress reports between November 1988 and February 1990. The Department has, among other actions, implemented a public information strategy and streamlined enforcement efforts between Headquarters and the regions.

The impact and effects of the SIMA program have not been measured

19.38 The 1988 departmental study addressed operational issues. The Department of Finance has been conducting ongoing monitoring of anti–dumping and countervailing cases. However, since 1984, when the SIMA legislation came into force, Finance has not completed a formal evaluation of the potential positive and negative effects of the program.

19.39 Finance informed Parliament, in its Part III of the 1991–92 Estimates, that it planned to review and assess the impact of import legislation on the competitiveness of domestic firms. It indicated to us that work on the review had commenced in the spring of 1991 but was suspended due to the uncertainty of the timetable for completing the current Uruguay Round of the GATT Multilateral Trade Negotiations.

19.40 We conducted a search of related literature to ascertain if it would

Exhibit 19.5

Case: Carbon Steel Welded Pipe from Brazil, Luxembourg, Yugoslavia, Belgium, France, Poland and Turkey

Date	Event
16 September 1987	Investigation initiated.
7 December 1987	The Department extended the 90–day limit for making a preliminary determination to 135 days to allow for discussion of undertakings.
29 January 1988	On the 135th day, the Department accepted undertakings given by exporters from Brazil, Luxembourg and Yugoslavia accounting for 92% of subject goods imported from the seven countries. Investigation was suspended concerning subject goods from these three countries as well as from Poland and Turkey. Due to the negligible volume of dumped imports, the investigation was terminated with respect to subject goods from Belgium and France.
18 January 1991	The Department renewed the undertakings following a review.
January – June 1991	Some 1,880 metric tons of subject goods contained in nine shipments from two major Brazilian exporters were imported to Canada at less than the undertaking prices, with estimated margins averaging 7%.
25 September 1991	The Department terminated the undertakings after discovering the violations. A preliminary determination was made the same day based on 1987 data.
23 January 1992	CITT made injury findings in the case of the subject goods from Brazil. Past injury was found on subject goods from Luxembourg, Yugoslavia, Poland and Turkey.

Note: Retroactive dumping duties could only be applied for importations from Brazil during the 90–day period preceding the termination of the undertakings. Therefore, duties were not applied to the nine shipments made from January to June 1991.

be reasonable and appropriate to examine the effects of the SIMA program. We identified a number of potential effects — both positive and negative — of SIMA–type programs. Some of the more important potential negative effects that need to be considered in an evaluation include the following:

- Protection afforded may shield domestic producers from competition, thereby possibly diminishing their efficiency and capacity to compete in the long term.
- Protection may harm Canada's relationship with trading partners, possibly by creating a perception that foreign exporters are being harassed.
- Protection may be detrimental to consumers, possibly increasing production costs and the ultimate prices of consumer goods.

19.41 The conclusion of the Uruguay Round of trade negotiations would be an opportune time to amend the Special Import Measures Act. Moreover, the Canada–United States Free Trade Agreement requires the two governments to establish a new regime to deal with dumping and subsidization rules for bilateral trade. We are of the opinion that there would be merit in resuming the evaluation work to determine if the existing policy framework balances the rights and obligations of all parties and best serves the Canadian interest. This would afford the Department of Finance with a policy position to assess the impact of the GATT proposal and to make policy changes should negotiations be concluded, and to develop mutually advantageous rules on this subject with the United States.

Conclusion and Recommendation

19.42 We found that, in general, the Department has taken reasonable steps in its handling of complaints, initiation of investigations and conduct of dumping determination. Our examination revealed a number of areas where SIMA administration needs to or could be improved. Some of these are administrative procedures of the Department; others are limitations resulting from certain technical aspects of the legislation.

The Canada–United States Free Trade Agreement requires the two governments to establish a new regime to deal with dumping and subsidization rules for bilateral trade.

19.43 In addition to the time and effort spent by corporate executives, a full–length proceeding under the SIMA process costs each party no less than an estimated $40,000. In some cases, the estimated costs have escalated to over $1 million. We have offered our views in this chapter on certain technical limitations where possible legislative changes would facilitate termination of an investigation when it is not warranted and would better secure undertakings as a less costly alternative to a full proceeding. We consider our views to be consistent with the current policy intent.

19.44 We have also commented on the lack of formal evaluation of the program by the Department of Finance. Such evaluation effort is needed to determine if the balance of rights and obligations established in 1984 continues to be appropriate in the present trade environment and in the foreseeable future.

19.45 The Department of National Revenue — Customs and Excise should maintain a broader perspective to give greater consideration to injury during the investigation stage leading to preliminary determination, and should implement its plan to monitor undertakings closely in its administration of the Special Import Measures Act.

Department's response: *We are pleased with the overall results of the comprehensive audit and that it demonstrates that we have taken reasonable steps in administering the Special Import Measures Act. We undertake to keep our administrative procedures under review in order to continue to improve, wherever possible, service to* *all parties affected by the legislation. We will also more actively pursue the possibility of using mutually agreeable undertakings to provide all those affected by an investigation with an option to the costs of the full legislative anti–dumping/countervailing duty process under SIMA. When the outcome of the conclusion of the Uruguay Round of negotiations under the GATT is clear, consideration will be given to ways in which the administrative process can be altered to provide for further examination of the question of injury prior to the preliminary determination. Our regional offices are now actively monitoring undertakings so that any potential violations can be identified in a more timely manner.*

19.46 The Department of Finance should resume and complete its formal evaluation of the import policy framework. It should also consider, if appropriate, proposing amendments to provisions of the Act concerning the limitations on investigation by the Department of National Revenue — Customs and Excise in cases referred to the Canadian International Trade Tribunal for advice on injury, and to the provisions for veto of undertakings.

Department's response: *We agree with the recommendation. It is our intention that as the outcome of the Uruguay Round of Multilateral Trade Negotiations becomes clear, we will intensify our work toward this end. This review will, inter alia, investigate, in consultation with the Department of National Revenue — Customs and Excise, some of the administrative issues raised in the report and will consider whether legislative changes to SIMA are appropriate. Obviously, we will have to examine the recently negotiated North American Free Trade Agreement as well.*

Chapter 20

Department of National Revenue – Customs and Excise

Goods and Services Tax: Registration and Related Sub–Activities

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Assistant Auditor General: Shahid Minto
Responsible Auditor: Nancy Cheng

Department of National Revenue – Customs and Excise

Goods and Services Tax: Registration and Related Sub–Activities

Main Points

20.1 With only 20 months available from the time of the budget announcement and despite passage of the legislation on 17 December 1990, the Department managed to put systems and procedures in place to start administering the Goods and Services Tax (GST) by 1 January 1991.

20.2 The Department achieved its registration target of 1.6 million by April 1991. However, we observed that many follow–up and maintenance actions are still needed in the registration program, which limits its capacity to identify new registrants. In addition, many accounts were cancelled without proper supporting documentation and the requirement for certain pertinent data was dropped from the original design of the registration form.

20.3 The Department had implemented an extensive program to provide information to the public before the tax took effect. The demand for information services by telephone was massive in 1991–92, requiring resources to be redeployed from the registration program and other enforcement activities. In responding to written queries, the Department needs to reassess its target response time, prioritize the requests, explore ways to better communicate changes to users and work with the Department of Finance to recommend timely enactment of proposed legislative amendments.

20.4 Almost 1.6 million of the 1.7 million registrants are small businesses filing returns on a quarterly basis. Although legislation provides certain options for simplification, they were chosen by few small businesses. The Department has started to address concerns to help simplify administration for the small business sector and itself. We believe that further simplification has the potential for significant efficiency gains to both registrants and the Department.

20.5 The reporting of the start–up costs for GST was fragmented. Although many departments and agencies were involved, the overall costs were not consolidated and reported to Parliament. Furthermore, accountability and reporting for the development of the GST automated system, a major Crown project, need to be improved.

Background

20.6 The Excise Tax Act was amended to replace the Federal Sales Tax with the Goods and Services Tax (GST), effective 1991. The implementation of this new sales tax completed the second stage of tax reform. The first stage, income tax reform, was implemented in 1988.

20.7 The Federal Sales Tax had been a single–stage tax with a narrow tax base. By contrast, the Goods and Services Tax is a multi–stage sales tax applicable to most goods and services consumed in Canada. Sales tax reform has affected businesses and consumers and required the participation of a number of government departments and agencies. Interdepartmental committees were struck to facilitate and co–ordinate the preparation and implementation of the GST.

20.8 The Department of National Revenue – Customs and Excise is responsible for administering the Excise Tax Act; the Department of Finance is responsible for sales tax policy and legislation. Some of the original departments and agencies are no longer involved with the GST, while others continue to play important roles. For example, the GST Consumer Information Office was established to inform consumers and receive complaints about the impact of the proposed GST on prices of consumer goods and services; the Department of National Revenue – Taxation administers the GST credits through the income tax system for qualifying individuals.

20.9 The reform increased the taxpayer base from about 75,000 licensed manufacturers, including those deemed to be manufacturers, to over 1.7 million GST registrants. The Excise Branch of the Department has gone through its most significant change since the inception of the Federal Sales Tax in 1924. Its staff increased from about 1,600 person–years in 1988–89 to approximately 5,600 person–years by 1991–92, serving in Headquarters, 56 regional and district offices, and a processing centre temporarily located in Ottawa. Customs ports have also taken on additional responsibility, collecting GST on goods imported into Canada.

20.10 Although the Department had been studying commodity tax reform for some time, it had only 20 months after the budget announcement in 1989 to prepare and implement the new sales tax. Many of the major tasks and the corresponding milestones had to be met within the 20–month period. Some tasks involved setting up the Branch's new infrastructure, including opening new district offices and the interim processing centre, recruiting and training new staff, and developing departmental policies and procedures and automated support systems to administer the tax. Other tasks involved certain sub–activities, including registering businesses and organizations, and informing them about the GST.

Sales tax reform has affected businesses and consumers and required the participation of a number of government departments and agencies.

20.11 The registration program is a major compliance sub–activity of the GST. In general, every supplier operating in Canada with revenues exceeding $30,000 annually from taxable supply of goods and services ought to apply and register with the Department. Making a taxable supply is defined in the Act as the provision of property or a service in the course of all commercial activities other than those specifically exempted. Registrants are liable for collecting and remitting the GST to the Department, net of any input tax credits to which they are entitled. The Department's implementation plan included identifying potential registrants, setting up registrant accounts, accepting and processing registrant elections and applications by January 1991, and preparing for the filing of returns and remittances from registrants by February 1991.

20.12 Informing suppliers of goods and services about the GST was another critical element in preparing and implementing the new tax. Businesses

The Department managed to put in place an infrastructure to start administering the GST by 1 January 1991, the date it took effect.

and organizations also had to prepare for the GST. They had to be in a position to start charging and collecting the GST on 1 January 1991. Although the need to inform suppliers continued after the GST took effect, the Department viewed January 1991 as a significant milestone.

20.13 The Department's planning and implementation of the GST was an enormous task. It was particularly difficult given the limited time available. The Department managed to put in place an infrastructure to start administering the GST by 1 January 1991, the date it took effect.

Audit Scope

20.14 The audit focussed on the registration program and the Department's information services to suppliers, including some aspects of the GST automated system supporting these areas. We also examined accountability for, and reporting on, the Department's preparation and implementation of the GST.

20.15 We selected the registration program as an audit area primarily for two reasons. It was among the major tasks undertaken by the Department; and it forms the basis for tax administration. Its significance extends beyond setting up new accounts. It authorizes suppliers to collect GST and establishes a taxroll for compliance verification, collection and audit enforcement. We expected to find systems and procedures for proper identification and follow–up of potential registrants, ensuring timely actions and adequate coverage.

20.16 The information services function is fundamental to a self–assessing system as it fosters voluntary compliance. Suppliers have to understand their entitlements and obligations before they can comply with the law. In this area, we expected timely dissemination of appropriate information and procedures to ensure that the legislation was interpreted consistently.

20.17 The sales tax reform was a major government initiative, and its preparation and implementation involved significant costs. We looked for mechanisms in place to establish accountability for such expenditures and to report on them.

20.18 We carried out our work mainly in the Excise Branch at Headquarters, five regional offices and some of their district offices, and the interim processing centre. We also interviewed staff from the Information Technology Branch of the Department.

Observations and Recommendations

Registration

The Department achieved its registration target of 1.6 million despite late passage of the legislation

20.19 The first step in the registration program was to identify and contact potential registrants. Due to the nature of the GST, the Department had to contact virtually every business and organization to determine whether they ought to register. In its plans, the Department set an objective of registering 1.6 million suppliers and indicated that it would prepare a master list for initial mailing from information contained in the income tax system.

20.20 In August 1989 the Department generated a master list of potential registrants from four databases — corporate, individual, payroll deduction and charity. It then attempted to eliminate some of the duplications arising from combining the databases. In April 1990 the Department sent out approximately 1.9 million registration kits to potential registrants, followed by two sets of reminder notices sent in June and August 1990 respectively. In the August 1990 mailing, a further

180,000 kits were sent to potential registrants newly identified from updated income tax data. In November 1990 a final national mailing of registration kits was sent to some of the potential registrants who had not yet responded to the Department.

20.21 The Department's plan for the registration program included two major assumptions. It anticipated a full 12 months from the time the proposed GST legislation received royal assent to the date the tax would take effect. It also expected that registration would be mandatory and enforceable.

20.22 In reality, the Bill introducing the legislation for the proposed GST received royal assent only two weeks before the effective date, 1 January 1991. Until the Bill was enacted, the requirement to register was neither mandatory nor enforceable. The delay in passage of the legislation may have led potential registrants to question whether the GST would indeed come into effect. Some may also have refused to register voluntarily before the legislation became effective. The Department's role was limited to informing potential registrants and advising them to register.

20.23 Exhibit 20.1 shows the progress and results of the registration program from May 1990 to April 1991. Potential registrants' response to the campaign was slow at the start. The rate of response doubled in the months following each mailing of reminder notices. Yet, by the end of September 1990 – three months before the proposed implementation date – registrants numbered only 500,000, less than a third of the Department's objective. On 3 October 1990 Headquarters instructed regional and district staff to contact potential registrants by telephone and advise them to register. In December 1990, with the passage of the legislation, registration requests arrived in record volume and continued to mount in January 1991. In the end, the Department had registered 1.1 million businesses and organizations by 1 January 1991, and achieved its target of 1.6 million registrants by April 1991.

Some follow–up and maintenance actions have been taken but many are still needed

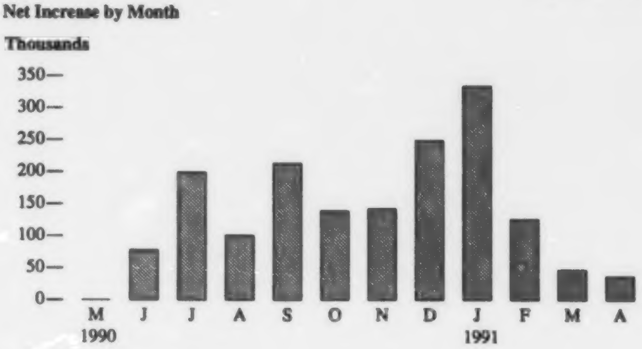
20.24 In the months following royal assent, the Department was inundated with last–minute registration applications. The actions required to follow up, adjust, correct and maintain registrant accounts dominated the operations of the regional registration program in the remaining months of 1991.

The actions required to follow up, adjust, correct and maintain registrant accounts dominated the operations of the regional registration program in 1991.

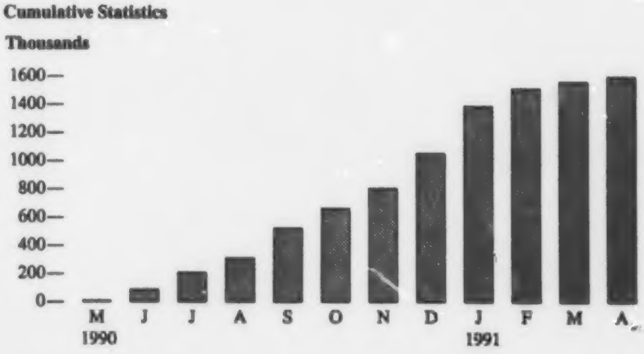
20.25 Under the Excise Tax Act, various election options are available to registrants. The elections are required to

Exhibit 20.1

Number of Registrants May 1990 to April 1991



Net Increase by Month



Cumulative Statistics

Source: Customs and Excise, Excise Operations

be filed in a form and manner prescribed in regulations made pursuant to the Act. With only two weeks between royal assent and the effective date of the GST, the primary task at the time was to have the regulations and the election forms in place, and there was only limited time to inform the public about the elections. As many registrants were uncertain about them, errors were made in completing the forms and some registrants filed elections without fully understanding their implications. In some cases, registrants mistakenly completed and returned election forms that did not apply to them. All of this required follow–up and corrective action by Excise staff.

20.26 Moreover, decisions on the design and development of the automated system had to be made well before the regulations were in place. Consequently, there were types of transactions that had not been anticipated in the system design. For example, the decision to permit joint filing for closely related corporations was made after system design was committed. Thus the system does not have the capability to process these filings and they have to be handled manually by Excise staff.

20.27 Furthermore, the legislation requires non–residents without a permanent establishment in Canada to provide security bonding when they apply to register. Non–resident registrants faced the difficulty of identifying companies that would provide the performance bonding required by the Department. The Department also did not require non–resident registrants to indicate whether they had a permanent establishment in Canada. The Department extended the time limit on providing security to April 1991, and, in September 1991, it listed acceptable bonding companies in its directives to the staff. However, non–residents continue to have difficulty locating companies to fulfil the bonding requirement, and resources still have to be used to contact many of these registrants and to obtain the security.

20.28 From 17 December 1990, the date of royal assent, until 26 March 1991, the influx of requests for registration was so intense that the Department decided to accept registration by telephone. The decision was made because the Department estimated that about 50 percent of these registrants would not have been able to register otherwise. However, the decision increased the risk of errors and required follow–up action on registrants who failed to subsequently file signed registration forms with the Department.

20.29 During the peak of the registration program, the Department conducted limited checks on submitted forms before processing them. In some cases, staff were instructed to insert standard values so that the registration could be accepted by the system. For example, the staff inserted a standard figure as the sales volume if it had not been provided by the registrants. This resulted in a need to contact registrants to confirm data on the forms or complete missing information, some of which involved correcting the GST registrant database. In addition, there were instances where the standard values caused processing errors in subsequent transactions on the registrants' accounts.

20.30 The workload arising from these circumstances was in addition to actions required in following up the initial registration program. These actions consisted of tracking undelivered kits and contacting potential registrants who had not responded to the initial registration kits.

20.31 In the latter part of 1991, Headquarters assigned high priority to registration actions. Regions were instructed to follow up registrant files including undelivered kits, obtain security from non–resident registrants, obtain outstanding and signed registration forms and resolve possible duplication of accounts.

20.32 At the end of March 1992, we noted that some progress had been made but that many of these actions were still needed. Only four of the nine regions had started to follow up potential registrants who had not returned the forms; three regions had yet to start tracking undelivered kits; and in four regions security from many non-resident registrants had yet to be obtained.

Regional identification has been hampered by follow-up actions

20.33 The income tax databases provided a starting point for the identification program. However, information contained in the databases does not always reflect the current business operations of the individual or corporation, because returns are usually filed after the corresponding period has elapsed. Some gaps also exist by nature of the suppliers' operations. For example, partnerships were not required to file income tax returns and thus would not have been included in the initial selection, but the individual partners would have been subject to selection through the individual income tax database. Other gaps might exist through non-compliance with income tax legislation. As a result, further identification of potential registrants is needed to narrow these gaps.

20.34 The Department developed internal policies and procedures and, in July 1991, distributed a regional identification program manual instructing the staff to identify potential registrants on an ongoing basis. In addition to possible gaps accounted for by new businesses formed after 1989, the staff were directed to focus on several major groups of potential registrants who might not have been included in the income tax data. For example, non-profit organizations and unregistered charities operating at a local level, unincorporated businesses, and businesses involving primarily cash transactions, particularly in the service sector, are among those identified in the manual.

20.35 However, for most of 1991 the staff were occupied with follow-up and maintenance of the initial registration program, thus limiting their capacity to actively identify new registrants. In February 1992, the Department outlined its policy and procedures for the regional identification program, requiring that each region establish a system to conduct ongoing identification, and providing guidance to the staff. By the end of March 1992, the regions were at different stages of the program. Some had begun active identification, while others were just starting to follow the program.

Account cancellation could increase the government's exposure to revenue loss

20.36 Under the Act, the Department may cancel a registration if it is satisfied that the registration is not required. For example, a registrant could have ceased operations in Canada or have become a small supplier, and thus no longer be required to be registered.

20.37 Cancellation involves de-registering or closing an account. Accounts that have been de-registered are to be brought forward to some future date for further compliance action. According to the Act, a supplier must remain registered for at least a year before de-registration is permitted. However, early in the program many cancellation actions were needed simply to correct registrations made in error, or for those who had registered more than once. The Department made exceptions in these cases and instructed the regions to waive the one-year rule provided the following conditions were met:

- the cancellation was requested in writing, on business letterhead if available;
- the person had qualified as a small supplier since 1 January 1991; and
- the person had never collected the GST.

Through a consultation process, the Department decided to limit the application to a one–page form to simplify its completion and encourage voluntary registration.

In March 1992, we found that the regions continued to face many competing priorities.

20.38 Further to its directives, accounts can be closed only if there are no actions pending, such as the filing of returns, collection or audit. These accounts are not subject to further action.

20.39 In our field visits, we reviewed a number of cancelled registrant files. We observed that procedures varied between regions and that regional staff were not certain whether to de–register or to close certain accounts. We also observed a lack of supporting documents for many de–registrations and closed accounts, in some cases including a statement of the reasons for the cancellation.

20.40 If an account is de–registered when it should be closed, the further action required for de–registrations adds to the regional workload unnecessarily. Accounts that are closed when they should be de–registered bypass further compliance actions, with implications for potential revenue loss. For example, a supplier can be deemed to have made a supply and be required to pay GST on the fair market value of the assets used in its commercial activities at the time it was de–registered. De–registered accounts also serve as a source of information for monitoring suppliers who, in time, may be required to register. Furthermore, in the absence of supporting information, a decision to cancel a registration could not be reviewed or challenged. Literature on other countries' experience also shows that changes to the status of registrant accounts, such as account cancellation, represent an area that exposes the government to loss of revenue.

Registration form lacked certain data needed for administration

20.41 The registration form was intended to provide the Department with basic data in a standardized format for administering the tax. In its design, consideration had been given to keeping the form simple, easy to understand and complete, and focussing on data elements common to most applicants. Through a consultation process, the Department decided to limit the application to a one–page form to simplify its completion and encourage voluntary registration. In the final format, many data elements were dropped.

20.42 For instance, we noted that there are no standard codes to categorize applicants' industries. The Standard Industrial Classification code was one of the data elements considered during the design stage but subsequently dropped from the final form. The industry classification is important in helping to target registrants for compliance actions and audit. It could also serve to target the dissemination of information for registrants and users in the various industrial sectors.

20.43 Additional data from registrants has to be obtained when future contacts are made. Some efforts have been made to code accounts using the brief description of the business that the registrants provide on the forms. However, at the end of March 1992 we were advised that over 700,000 accounts had yet to be coded.

20.44 In the fifteen months since the GST became effective, the Department has registered an additional 700,000 applicants and conducted many follow–up actions. In March 1992, we found that the regions continued to face many competing priorities. In some regions where an active identification program has been started, data have been obtained from municipalities or other organizations and used in the ongoing identification program. Other taxing authorities have similar tasks in attempting to identify cash–based operations and those in the "underground economy". In our view, there would be merit in exploring an exchange of information and strategy with them.

20.45 The Department should, in addition to monitoring operations closely, re–evaluate priorities periodically to ensure that there is a proper balance between the ongoing

identification programs and follow-up and maintenance actions. It should consider putting in place means to facilitate a further exchange of information and techniques with other taxing authorities, to help identify registrants.

Department's response: We currently monitor operations via reporting from field operations, and re-assess work priorities on a quarterly basis. We now have an exchange-of-information agreement with some provinces. Current initiatives call for active co-operation and co-ordination with other federal departments and agencies.

Information to Registrants

An extensive program was in place to provide information to the public before the tax was implemented

20.46 Informing the public about the GST was one of the Department's priorities in planning and preparing to implement the tax. In addition to providing information on how the GST ought to be charged, collected and remitted, and on the proper filing of the returns, the Department has the responsibility to help suppliers differentiate among goods and services that are either taxable at the 7-percent or the zero rate, exempt or not taxable.

20.47 The Department conducted widespread consultation programs to seek input from businesses, trade associations and professionals on how to disseminate information and develop its administrative procedures. A publication committee was formed to steer the development of guides, information pamphlets and technical memoranda. Consultants were retained to conduct focus testing to review some of the publications and make them more understandable. By the end of 1990, the Department had launched an extensive program to provide information to suppliers and organizations, consisting of information seminars and publications and supported by enquiry staff in the regions.

Resources were redeployed from other operations to meet the high demand of telephone enquiries

20.48 In Part III of its 1991-92 Estimates, the Department forecast 950,000 requests for information. It anticipated that these would be telephone enquiries, written requests, and office consultation and seminars. Resources were allocated to this sub-activity on the basis of the anticipated workload.

20.49 In the months before and after the tax took effect, the volume of requests was so overwhelming that the Department doubled the 1991-92 forecast to 2 million requests in its plans. It expected over 90 percent of the requests to be by telephone.

20.50 The Department's records show that the actual number of calls answered in 1991-92 was just short of 3 million, about three times its original forecast. Although telephone enquiries peaked in January 1991 when the GST came into effect, their volume continued to be significant, especially around the end of quarterly filing periods. We noted that the Department started in the fall of 1991 to identify the questions most commonly asked in the regions and has just started to analyze the information. From September 1990 to March 1991, the Department had commissioned surveys on the program's accessibility and responses. However, since then the Department has not reviewed the quality of staff responses in the telephone enquiry program.

The actual number of calls answered in 1991-92 was about three times the original forecast.

20.51 To meet the high demand of public enquiries, the Department redeployed resources from the registration program and other enforcement activities. This added to the backlog in follow-up and maintenance actions and in the registrant identification program in the regions. It also delayed some enforcement activities. For example, the Department's 1991-92

Estimates forecast that collection action would be taken in 200,000 cases. However, as of 31 March 1992, the Department estimated that 30,000 collection cases had been completed, or 15 percent of the number forecast.

Prioritizing interpretation requests could improve service to the public

20.52 Many registrants and professionals request information in writing, seeking some degree of certainty about the Department's interpretation of the Act in administering the GST. Some requests may involve broad application of the law; others may be specific to certain contemplated transactions. The interpretation services staff respond to the requests on the basis of positions taken by the Department. This service is an essential element of voluntary compliance. It is complemented by publications and other forms of information dissemination.

20.53 The Department announced that it would respond within 21 days after receiving a written request. We examined a number of requests made in the regions, particularly in sectors with the most volume. We found that during 1991–92 the actual response time far exceeded the 21 days. For example, responses to queries relating to non–residents took an average of 72 days; responses relating to real properties took an average of 43 days. Our analysis also showed that the response time was improving by early 1992 but the goal of 21 days remains optimistic. The Department needs to re–evaluate its goal for response time and advise users accordingly.

The Department needs to explore additional means to inform registrants of subsequent changes.

20.54 We found that, in allocating or prioritizing the requests to interpretation staff, the Department does not differentiate between issues where clear administrative policies are in place and those that may require further analysis. We observed that the queries are allocated to staff, and handled, on a first come, first served basis. Some requests concern routine matters but others may need a more timely response, especially if the provisions in question affect the way the suppliers carry on their day–to–day business. We believe that ranking requests in order of priority would improve service to the public.

20.55 All departmental responses contain a disclaimer that the interpretation is subject to changes in the law and in the Department's interpretation and administrative policy. We found that the disclaimers included in the responses were inconsistent and sometimes unclear. This detracted from the greater certainty that the interpretation services were intended to provide. A GST memorandum on these services was issued in late January 1992. It standardized the wording used in the disclaimer and provided the readers with some guidelines on the limitations.

20.56 The Department highlights changes it considers significant in the Excise News, which is circulated quarterly to all registrants. In addition, technical information bulletins on specific subjects are issued from time to time to tax professionals. However, the onus is on those seeking the interpretation to keep up–to–date on any changes themselves. The Department needs to explore additional means to inform registrants of subsequent changes, especially where they involve the Department's interpretation and administrative policies.

Interpretation services are affected by many proposed technical amendments that are still not supported by draft legislation

20.57 Interpretation of tax provisions is complex and technical. In this case, the task is particularly daunting, given that the tax only recently came into effect and its provisions have not been tested in the courts. The Department has been identifying issues and policy areas that need to be clarified but it will take time to resolve them. However, we noted another limiting factor that adds to the uncertainty that registrants and the Department face in analyzing GST implications.

20.58 The Goods and Services Tax received royal assent on 17 December 1990. From then until 31 March 1992, there were four Notices of Ways and Means Motion proposing amendments to the Excise Tax Act, many to be effective retroactively to 1 January 1991. The first of these was released on 18 December 1990, immediately after royal assent; the last was released on 10 March 1992. The table in Exhibit 20.2 shows the diversity of amendments proposed in these Notices and in press releases. However, as of 31 March 1992, no draft legislation had been tabled for any of the proposed amendments.

Exhibit 20.2

Table of Proposed GST-Related Amendments to Legislation
17 December 1990 to 31 March 1992
Selected Examples Only

	Transitional Treatment	**Import/Exports**	**Financial Institutions**	**Real Property**	**Public Sector Bodies**	**Administration and Others**
17 December 1990*						• Prescribed list of tax-free items for farmers and fishermen
18 December 1990	• Instalment payments • Transportation services and • others	• Rebate to unregistered non-resident • Tourist rebates	• Insurance, warranties and damage claims	• Residential exemptions • Real property leases		• Direct sellers • Taxi and limousine services and • others
27 March 1991	• Conditional sales contracts • Adjustments to self-assessed GST	• Drop-shipments on behalf of non-residents • Imported goods re-exported or re-valued and • others	• De minimis financial institution test • Definition of listed financial institution and • others	• GST housing rebate • Residential property and • others	• Public sector body rebate regulations – definition of government funding • Definition of health care facility and • others	• Quick method accounting • Employee benefits, allowances and rebates and • others
24 June 1991*	• FST housing rebate • Grandfathered new housing		• Shares in co-operative corporations			• Feedlots
5 November 1991		• Supplies to international carriers • Supplies of services to non-residents and • others	• Definition of financial services • Seizures and repossessions and • others	• Residential property • Sales of used housing and • others	• Sales by governments • Special fund-raising events by registered charities and political parties and • others	• Capital property and change-of-use rules • Employee and partner rebates and • others
24 January 1992*						• GST component of taxable benefits clarified
10 March 1992	• FST Housing Rebate	• Imports by exporters of processing services	• Goodwill supplied by a financial institution		• Unbottled water	• FST inventory rebate • Joint ventures and • others

GST – Goods and Services Tax; FST – Federal Sales Tax

Source: Press Releases (*) and Notices of Ways and Means Motion issued by Department of Finance.

20.59 The issues addressed in the proposed amendments affect many types of businesses and organizations. They range from residential properties in the real property sector and the de minimis rule for financial institutions to joint venture elections and registration requirements for taxi and limousine services.

Registrants need to comply with the precise provisions of the legislation and the Department needs to administer them on the same basis.

20.60 A Notice of Ways and Means Motion is usually drafted in fairly general terms. However, registrants need to comply with the precise provisions of the legislation and the Department needs to administer them on the same basis. The delay in introducing and enacting the legislative provisions has made it difficult for everyone concerned to comply with the proposed amendments. The Department provides general interpretation on GST matters but has taken a position to not issue rulings if they involve measures proposed in Notices of Ways and Means Motion. This has restricted instances where a ruling may be obtained and has added to the uncertainty surrounding the GST.

20.61 The Department should analyze periodically the reasons for the high volume of telephone enquiries and determine what additional measures are needed to inform the public in order to reduce the demand for the telephone enquiry service. It should reassess its target response time for written requests, consider means to prioritize the requests and explore ways to better inform users of subsequent changes. It should also inform the Department of Finance of the difficulties caused by the significant delay in enacting the proposed amendments concerning GST and work with the Department of Finance to have the draft legislation put forth as expeditiously as possible for enactment.

Department's response: *We compile, on a quarterly basis, a list of the questions received from the public for analysis. We have engaged a private consultant to assist in exploring ways to enhance our communication and publication strategy including a nationwide survey to assess the quality, need and type of information needed by registrants. We have analyzed our response timeframe and revised our standard using our experience of the past year and a half. We respond to written requests for interpretations and rulings with due diligence.*

We maintain an ongoing dialogue with the Department of Finance. We continually express the urgent requirement for legislation to enact proposed amendments to the Excise Tax Act. We have participated extensively over the past two years in the development of the Technical Bill. We will continue to provide support and assistance to Finance in this regard and to press for early introduction of the draft legislation in Parliament.

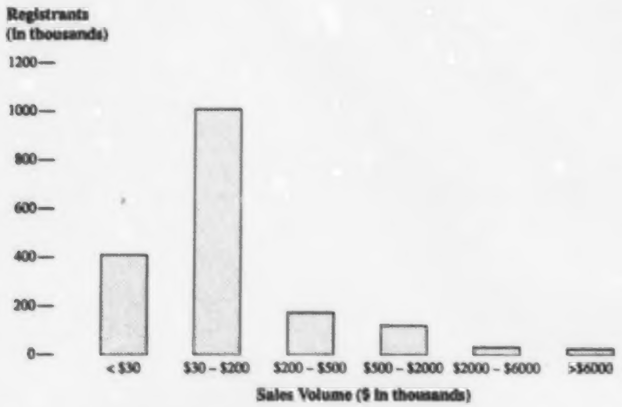
Simplification and the Small Business Sector

Most registrants are small businesses filing returns on a quarterly basis

20.62 Exhibit 20.3 provides a profile of the registrant base at the end of March 1992. Of the more than

Exhibit 20.3

Profile of Registrants by Sales Volume as of 31 March 1992



Source: Customs and Excise, Excise Operations

1.7 million registrants, only 25,000 or 1.4 percent have annual revenue from taxable sales exceeding $6 million. Close to 1.6 million registrants have annual taxable sales of $500,000 or less, accounting for about 90 percent of the base. Some 400,000 registrants in this group are small suppliers with taxable sales of less than $30,000 annually who elected to register, even though they are not required by law to do so.

20.63 The Act defines the filing frequencies required of registrants on the basis of the volume of their annual taxable sales. Large registrants, with annual taxable sales over $6 million, are required to file returns monthly; registrants with revenue not exceeding $500,000 are designated to file quarterly, but could elect to file monthly or annually.

20.64 In accordance with the Act, the Department has automatically assigned quarterly filing to all registrants below the $6 million threshold, unless they elect otherwise. As of 31 March 1992 only 43,000 registrants had elected to file annually, less than 3 percent of those who qualified. Exhibit 20.4 shows the actual and potential filing frequencies of the registrants as of 31 March 1992.

20.65 This has had a significant impact on small businesses and the Department. If half of all eligible registrants had chosen to file annually, up to 2.4 million returns and many corresponding transactions would not have been processed. The Department's records show that 7.1 million returns were filed in 1991.

Rate of rejection in processing of transactions continues to be significant

20.66 Within the 15–month period ended 31 March 1992, we noted that numerous transactions required intervention before their processing could be completed. Transactions that fail to meet processing requirements and edit checks are rejected and kept in holding accounts for follow–up and corrective action. Although input errors and exceptions are to be expected in automated systems, the rate of rejection in the GST system was high in early 1991 and remained significant at the end of March 1992. In 1991–92, about 10 to 30 percent of all input documents were sent to the work–in–progress (WIP) account to be resolved. The rate in March 1992 averaged between approximately 10 and 20 percent (see Exhibit 20.5).

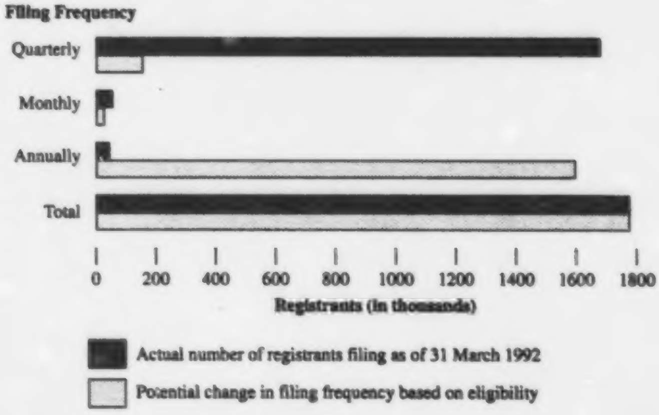
20.67 The Department allocated 30 person–years to process errors and exceptions at the interim processing centre. By April 1991, 20 more person–years had to be allocated to deal with the increasing volume of transactions in the WIP account. The person–year allocation was subsequently increased many times, to a total of almost 120 person–years by 31 March 1992 – four times the original allocation for the unit. The corrections and adjustments also involved, from time to time, regional staff responsible for various sub–activities, including compliance verification and audit.

As of 31 March 1992 only 43,000 registrants had elected to file annually, less than 3 percent of those who qualified.

20.68 Transactions in the WIP account can be posted to a registrant's

Exhibit 20.4

Profile of Registrants by Filing Frequency as of 31 March 1992



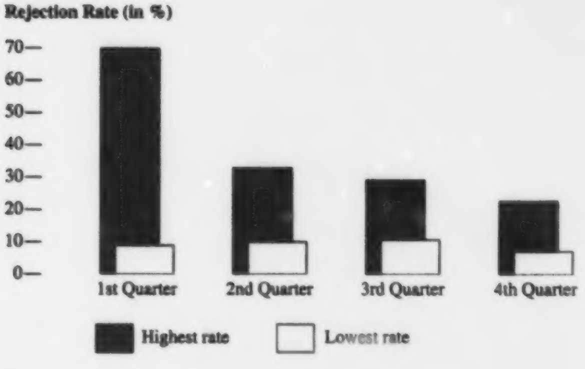
Source: Customs and Excise, Excise Operations

account only after the error condition has been resolved. In addition, subsequent returns cannot be processed until the previous return clears the system. Due to the volume of rejected transactions, many corrections and their corresponding postings were not made until some considerable time after the filing and remittance had been submitted. Consequently, field officers often did not have up–to–date information to respond to registrants' queries on their accounts. In one instance, a payment made on 30 September 1991 was not posted until 23 December 1991, after the district office had requested that the payment be located and applied. In another case, on 30 December 1991, six months after the registrant made the payment, the district requested that it be traced and applied.

20.69 Moreover, the delay in updating accounts has had an effect on compliance and enforcement activities. The system automatically generates monthly notices of failure to file or pay. Since many accounts were not up–to–date, early notices had to be withheld; the first notices were not issued until October 1991. During the summer of 1991, Excise staff had screened registrants manually and followed up on some of the delinquent registrants they considered high–risk. However, the collection activities started to become functional only in the fall and were still not fully operational when we visited the regions in February and March 1992.

Exhibit 20.5

Rejection Rate of Returns, Remittances and Other Input Documents Held in the Work-in-Progress Account for 1991–92



Source: Customs and Excise, Interim Processing Center

20.70 We reviewed the classification of transactions by error type contained in the WIP account during early 1992. We found that most of the rejected documents involved filing periods or dates that failed to meet automated edit checks. As at 31 March 1992, less than 7 percent of the rejections contained calculation errors; over 70 percent were due to date–related edits.

20.71 The automated system contains numerous edit checks to validate input data. However, there is zero tolerance for deviation from pre–set criteria within the edits. In addition, failure to pass any of the checks, critical or not, would cause the transaction to be rejected, delaying update to the registrant's account. The number of rejects and exceptions also reflects the need for more work by the Department to help registrants understand their required filing frequency or period and to maintain the data integrity of the Department's system.

Simplified accounting options were chosen by few small businesses

20.72 The Excise Tax Act and certain proposed amendments provide options to small businesses to account for and report net GST collected. For example, the "quick method" allows most businesses with annual taxable sales of $200,000 or less to calculate net GST payable using designated percentages, without accounting for GST paid on their purchases. This is intended to simplify the accounting needed for the GST, reducing compliance costs to small businesses and the administrative burden on the Department.

20.73 We noted that, as at 31 March 1992, over 1.4 million registrants were eligible to use these options. However, only 37,000 elected to do so (see Exhibit 20.6).

20.74 Although a GST guide has been issued explaining how simplified accounting options are used to calculate GST liability, many small businesses have been uncertain about their effect and reluctant to elect to use them. The Department needs to promote and explain to registrants the costs and benefits of the simplified accounting methods, to help them determine whether they will benefit from electing to use these methods.

20.75 At the end of 1991, the Department started a small business group in the Excise Branch. The group has been reviewing a number of issues dealing with administering the GST in a small business environment. Subsequent to our audit, the Minister of National Revenue announced a plan to simplify the GST for Canadian businesses.

Simplification and the small business sector offer opportunities for improvement

20.76 We have noted that most registrants are small businesses. Experience in administering the former Federal Sales Tax showed that most of the revenue was collected from a small percentage of the taxpayer base, the large manufacturers. We believe large registrants could continue to collect a significant portion of the GST. Therefore, streamlining its administration for the small business sector has the potential for significant efficiency gains to both the registrants and the Department.

20.77 We believe there are two areas worthy of future research and consideration:

- the over 400,000 small suppliers who registered although not required by law to do so; and
- the small supplier threshold of $30,000.

20.78 There are various reasons for small suppliers to have registered. For example, some customers may have demanded full GST credits from them; some small suppliers may have registered to apply for the one–time inventory rebate on the Federal Sales Tax; others may have registered because they believed they were required by law to do so. However, by registering, they have to charge customers GST on the supply of taxable goods and services, comply with filing and remittance requirements and incur compliance costs. The Department, in turn, incurs costs in administering the tax for these suppliers.

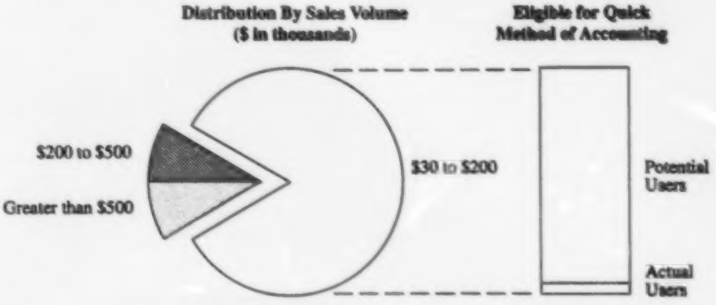
20.79 Both of these areas offer opportunities to streamline the registrant base and improve administration. In our view, it would be of benefit for the Department to compile data that would facilitate future consultation with the Department of Finance.

20.80 The Department will need information to help analyze policy options and determine the trade–off between fairness to registrants, effect on government revenues, and the costs to registrants and to the Department for administration. This information may include its administrative costs relating to the small suppliers who registered; the amount of GST revenue collected

The Department needs to help registrants determine whether they will benefit from electing to use simplified accounting methods.

Exhibit 20.6

Profile of Registrants
Eligible for Quick Method of Accounting
as of 31 March 1992



Source: Customs and Excise, Excise Operations

The Department will need information to help analyze policy options and determine the trade–off between fairness to registrants, effect on government revenues, and the costs to registrants and to the Department for administration.

and the input tax credit paid; and the compliance costs to these small businesses.

20.81 The $30,000 threshold permits small suppliers to be exempt from the GST system, thus reducing compliance costs to them and administrative costs to the Department. Measures will need to be established to monitor outcomes at the existing threshold level. The Department could start by maintaining cost data in a way that would allow it to identify the marginal costs of administering the tax at different thresholds for small suppliers.

20.82 The Department should continue its efforts and address issues arising in the small business sector. It should review tolerance limits in its automated system and establish allowable deviations for the edit criteria to reduce the number of rejected transactions and to provide more up–to–date information to operational staff. In addition, it should consider various options for improving the efficiency of administering the registrant base, and should compile revenue and cost data to support analysis of the appropriate treatment of small suppliers.

Department's response: *We are using production statistics and ad hoc system requests to determine what future activities are required and to target specific groups to whom these actions should be directed. The quick method of accounting for small business is being made a central theme of all new or revised publications. Adjustments, modifications and improvements to the quick method are constantly being reviewed. Simplification of the GST for the registrant base continues to be an ongoing priority for the Department and many recommendations on simplification are under review.*

Our Regional Co–ordinators collect information on how registrants think the Branch can adjust its compliance and administration guidelines to reduce the compliance burden while retaining reasonable financial integrity.

Accountability and Reporting

20.83 We examined the funding and reporting of the Department's expenditures from 1989–90 to 1991–92 relating to the start–up costs in preparing and implementing the GST.

20.84 In 1989–90 and 1990–91, approximately $422 million was voted through the Supplementary Estimates by Parliament to the Department for planning, preparing and implementing the tax. In the 1991–92 Main Estimates, a further $390 million was voted for the GST activity, which included funding for start–up costs and ongoing administration. The development of a GST automated system has been designated as a multi–year major Crown project with total funding of $233 million, most of which was included in the Estimates for these three years.

Reporting of costs for planning, preparing and implementing the tax was fragmented and not consolidated

20.85 In accordance with government requirements, the Department has reported its budgetary expenditures by the fiscal years in which they were incurred. However, it does not have a mechanism to account for its total start–up costs of preparing and implementing the GST. The Department classified GST–related costs that were incurred prior to 1 January 1991 as planning and preparation costs and reported subsequent costs as those for ongoing administration.

20.86 Other departments and agencies also incurred costs to introduce the Goods and Services Tax. The start–up costs the government incurred in total for the GST were not consolidated and reported to Parliament.

20.87 On the basis of departmental Estimates tabled in Parliament, we discussed budgetary expenditures on GST with the Excise Branch and other departments and agencies, to estimate the portion of the total administration costs that represented GST start–up costs. Exhibit 20.7 shows that the estimated start–up costs from 1989–90 to 1991–92 exceeded $800 million. The Department of Finance did not specify a budget figure for GST start–up costs, but in the February 1990 federal budget it provided a forecast of GST administration costs. We found that there was no departure from reporting requirements for budgetary expenditures. The costs were disclosed in various Main Estimates by year and were spread among all involved departments and agencies. However, given the nature and magnitude of the project, we believe the total start–up costs should have been consolidated and reported to Parliament.

20.88 In addition, some transitional costs took the form of foregone revenue and were not included in the budgetary expenditures. For example, a one–time transitional grant of up to $1,000 was available to small businesses to help them prepare for the GST. The Department of Finance forecast $900 million for the grants but the actual amounts claimed were never captured. Registrants were instructed to deduct the grant payment from the net GST payable to the Department and were not required to report the grant separately on the return. The absence of direct reporting makes it difficult to identify registrants who have taken the grants and thus to verify their claims, representing a lost opportunity for compliance verification.

Accountability and reporting for the development of the automated system need to be improved

20.89 The development of the automated system represented one of the major costs of preparing and implementing the GST. As a major Crown project, its progress is subject to monitoring and reporting to provide an appropriate control framework needed for projects of that size.

20.90 Users outside the Department were not involved in defining their needs from the system. For example, the system development team did not consult the Department of Finance to determine the system requirements that might assist in analyzing and discussing possible effects of provincial harmonization.

20.91 We also found that insufficient priority was given during the system's development to the departmental finance function in accounting for and reporting revenue. As a result, the system does not facilitate periodic reconciliation of monies collected, deposited and recorded in the central accounts with information recorded in registrants' accounts. The Department struck a management committee to address the weakness and, in early 1992, assigned priority to improve financial controls and conduct reconciliations. The data in the GST system were reconciled to the central accounts for the year ended 31 March 1992. However, system changes have yet to be made to strengthen financial controls and facilitate ongoing reconciliations. The Department advised us that the required system changes will be made in the near future.

20.92 The approval for the major Crown project was effectively granted

The Department of Finance forecast $900 million for small business transitional grants but the actual amounts claimed were never captured.

Exhibit 20.7

Estimated Start-up Costs for the Goods and Services Tax 1989–90 to 1991–92

	($ in millions)
National Revenue – Customs and Excise	$ 628
National Revenue – Taxation	50
Finance	29
Public Works	63
Supply and Services	22
GST Consumer Information Office	20
Statistics Canada	5
Justice	3
Total	$ 820

Sources: Allocation based on actual costs; Part III Estimates; and Customs and Excise, Excise Operations.

We found that progress reporting for the GST automated system was late or missing.

by Treasury Board in three stages between May 1990 and December 1991 as the system was being developed. The Department's task, to differentiate between system development and maintenance costs, has been difficult at times, especially when they were incurred as a result of legislative changes made after the GST took effect. Nevertheless, the classification of costs is important in determining the overall costs of the major Crown project and controlling its funding. The circumstances emphasize the significance of progress reporting on the project.

20.93 The Treasury Board requires progress reports of major Crown projects to be prepared and submitted periodically for review and monitoring. We found that progress reporting for the GST system was late or missing. By 31 March 1992, four semi–annual reports should have been submitted. Two were submitted late, by three and five months respectively; two were never submitted. We noted that the project's estimated costs were reported in Part III of the 1991–92 Estimates. However, the disclosure format provided cost information on only the capital portion. The reported amount represented about half of the funding approved nine months before the Estimates were tabled. The development of the GST automated system is planned to continue until 1995.

20.94 The Department should take action to ensure that the needs of all major users of the GST automated system are met, and consider means to improve its accountability and reporting on this major Crown project.

Department's response: *The GST system was developed within inordinately short timeframes and concurrently with, and in advance of some of, the legislation, regulations, policies and procedures including those of other major users. Subsequent enhancements and development are attempting to address the needs of those outside the Department, including the Department of Finance.*

Discussions have been held with Treasury Board with respect to reporting on the major Crown project and a detailed narrative report has been prepared. Future reporting requirements and parameters have been agreed to and every effort will be made to ensure timeliness of these reports.

Chapter 21

Department of National Revenue – Taxation

Resolving Disputes on Income Tax Assessments

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Department of National Revenue – Taxation

Resolving Disputes on Income Tax Assessments

Assistant Auditor General: Shahid Minto
Responsible Auditor: Jim Ralston

Main Points

21.1 Taxpayers who believe they have been treated unfairly are entitled to file an objection; this will initiate a review by National Revenue – Taxation appeals officers. Taxpayers who are not satisfied with the result of the review may appeal to the courts.

21.2 National Revenue – Taxation's Appeals Branch is committed to the impartial and timely resolution of taxpayers' disputes.

21.3 Appeals Branch's philosophy, organization and training is intended to foster impartiality. The Branch has some indicators of the extent to which it succeeds in its quest for fairness, but it is looking for further indicators. In particular, it is preparing to survey taxpayers on their perceptions.

21.4 Appeals Branch has grown in the face of an increasing workload and more exacting legislative requirements. Despite this growth in resources, the Branch is taking longer to resolve cases — on average over 3 months for simple ones and over 14 months for complex ones.

21.5 National Revenue – Taxation should make available to parliamentarians more information on performance in the dispute resolution process.

Introduction

21.6 The Income Tax Act gives taxpayers the right to dispute National Revenue – Taxation's (NRT) assessments of their obligations and entitlements. In 1991–92, this right was exercised by 63,000 of the approximately 20 million individual and corporate taxpayers.

21.7 As of the end of March 1992, over $2.5 billion in income taxes were in dispute. Taxpayers are not required to pay disputed assessments; however, under proposed legislative changes, large corporations would be required to pay a portion. Should the assessment be upheld, the taxpayer would have to pay the full amount as well as interest charges. Because the Department receives interest, there is no real revenue impact, but a dispute does delay the government's receipt of cash.

21.8 NRT's Appeals Branch is responsible for responding to taxpayers' objections and appeals. Many issues can be resolved by taxpayers requesting NRT to change their returns, but where issues cannot be resolved, there is a formal dispute resolution process. It starts when a taxpayer files a notice of objection with the Department, setting out the background and reasons for the dispute. (In this report we refer only to taxpayers, but in practice taxpayers may be represented by agents in their dealings with NRT.) The Appeals Branch reviews the objection, discusses the issues with the taxpayer and ultimately notifies the taxpayer of its decision.

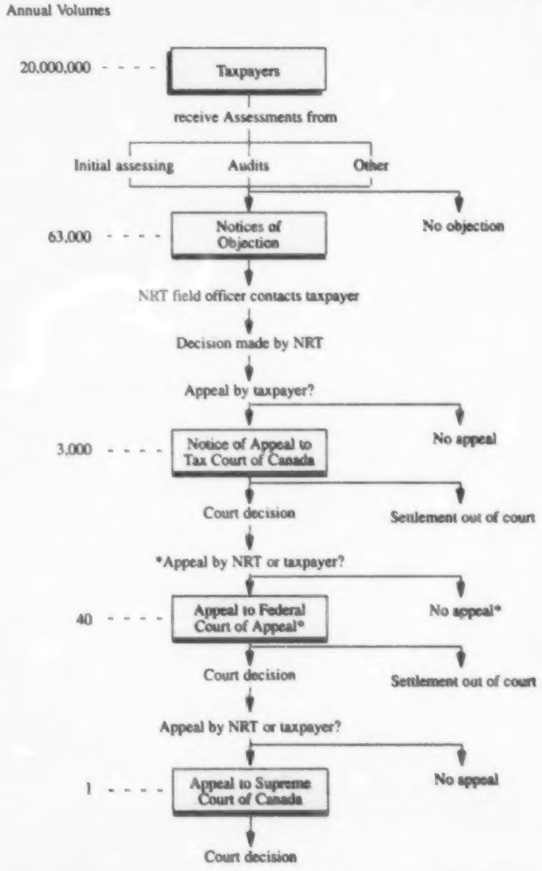
21.9 Objections are processed in most district offices and taxation centres across the country. Appeals are handled by separate teams of Appeals Branch officers in five district offices.

21.10 If taxpayers are dissatisfied with the Department's responses or do not receive them within the prescribed time limits, they may file a notice of appeal with the Tax Court of Canada. Court cases are handled on behalf of the Minister of National Revenue by Appeals Branch officers and Department of Justice lawyers. Either the taxpayer or NRT may take the Tax Court's decision to the Federal Court of Appeal and to the Supreme Court of Canada, if it agrees to hear the appeal.

21.11 When NRT finds, through the objections and appeals process, that an assessment error has occurred, it does not search for other taxpayers with comparable tax situations who may have received similar erroneous assessments but who have not filed an objection. In NRT's view this would

Exhibit 21.1

Taxpayer Dispute Process


Annual Volumes
20,000,000
Taxpayers
receive Assessments from
Initial assessing
Audits
Other
63,000
Notices of Objection
No objection
NRT field officer contacts taxpayer
Decision made by NRT
Appeal by taxpayer?
3,000
Notice of Appeal to Tax Court of Canada
No appeal
Court decision
Settlement out of court
*Appeal by NRT or taxpayer?
40
Appeal to Federal Court of Appeal*
No appeal*
Court decision
Settlement out of court
Appeal by NRT or taxpayer?
1
Appeal to Supreme Court of Canada
No appeal
Court decision

**Informal procedure allows for judicial review to Federal Court of Appeals only.*

not be practicable. However, it does happen that groups of taxpayers with common interests communicate results of disputes among themselves. The onus is on the taxpayer to contact the Department to resolve any perceived problems.

Objective and Scope

21.12 The objective of our examination was to consider how National Revenue – Taxation manages its dispute resolution process. Since the Department of Justice is involved in appeals, we included some aspects of their related activities in our examination. In addition, we wanted to determine whether Parliament is kept adequately informed of costs, resource requirements and performance. We excluded activities for resolving disputes pertaining to the Canada Pension Plan and Unemployment Insurance, which comprise a small part of NRT's activities.

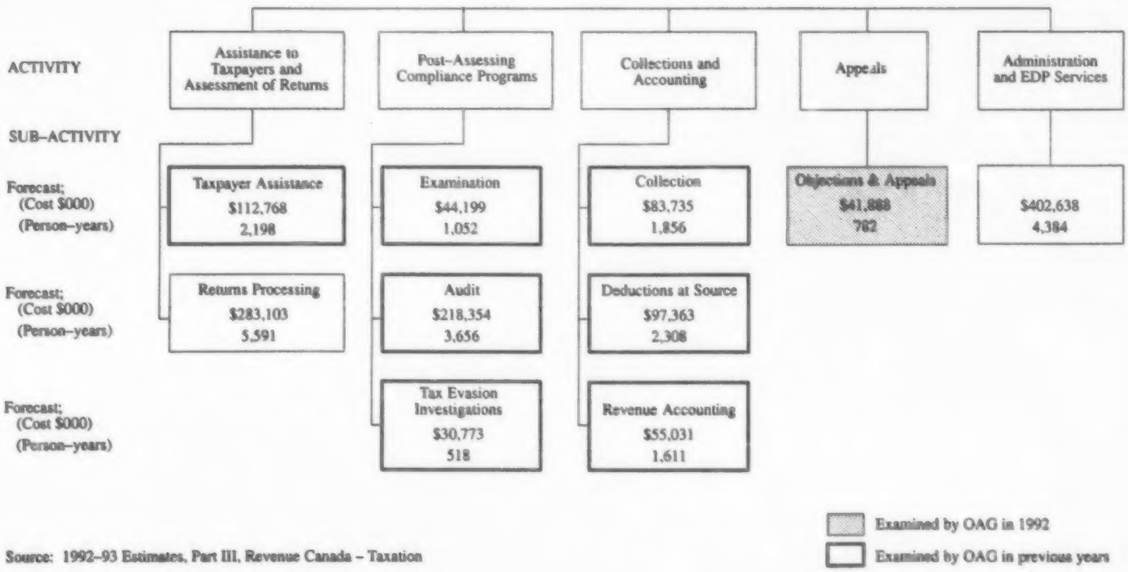
21.13 Exhibit 21.2 illustrates NRT's program structure and highlights the activities reviewed in the current and previous examinations. Activities reviewed during the current examination are expected to consume 782 person–years and $42 million — three percent of the Department's estimated resources for 1991–92. In the Department of Justice, activities involving appeals are expected to consume 147 person–years and $14 million.

21.14 Our examination included work in a number of NRT's district offices and taxation centres and its head office. Some Department of Justice offices were also covered.

Exhibit 21.2

Program Structure of National Revenue – Taxation

(Showing 1991–92 Forecast Expenditure)


ACTIVITY
Assistance to Taxpayers and Assessment of Returns
Post–Assessing Compliance Programs
Collections and Accounting
Appeals
Administration and EDP Services
SUB–ACTIVITY
Forecast; (Cost $000) (Person–years)
Taxpayer Assistance $112,768 2,198
Examination $44,199 1,052
Collection $83,735 1,856
Objections & Appeals $41,888 782
$402,638 4,384
Forecast; (Cost $000) (Person–years)
Returns Processing $283,103 5,591
Audit $218,354 3,656
Deductions at Source $97,363 2,308
Forecast; (Cost $000) (Person–years)
Tax Evasion Investigations $30,773 518
Revenue Accounting $55,031 1,611
Examined by OAG in 1992
Examined by OAG in previous years

Source: 1992–93 Estimates, Part III, Revenue Canada – Taxation

Observations and Recommendations

Fairness

21.15 It is essential that the dispute resolution process be fair and be seen as fair for taxpayers to want to use it. Timeliness is also an important aspect of the process. The Department's mission statement states its commitment to fairness, efficiency, responsiveness, accessibility and regard for continuous improvement. The Appeals Branch mandate reinforces NRT's commitment to resolve taxpayers' disputes in an impartial and timely manner and to explain to taxpayers the basis for its decisions.

21.16 This section deals with issues of fairness. A subsequent section deals with timeliness.

The Department informs taxpayers of their right to object and to appeal

21.17 A basic aspect of fairness is that taxpayers know of their rights and how to exercise them.

21.18 The Department informs taxpayers of their right to object and to appeal in assessment notices, letters and other public documents, such as the Declaration of Taxpayer Rights. The Declaration states:

> You are entitled to object to an assessment if you believe you have been treated unfairly.... Filing a notice of objection sets in motion an impartial review by our officers. If the matter is not resolved to your satisfaction, you can appeal to the courts.

21.19 In 1980, NRT issued an information circular for taxpayers that describes the process for resolving disputes. It explains that Appeals Branch officers contact taxpayers to obtain information and that decisions to cancel, change or confirm disputed assessments can be made only by the Chief of Appeals. Some cases may be referred to head office. Recently, the Department drafted a pamphlet intended to provide taxpayers with more current information on the dispute process. The Appeals Branch operating manual describes officers' roles in this quasi–judicial process and reminds them to inform taxpayers that any tentative decision is subject to approval by the Chief of Appeals.

It is essential that the dispute resolution process be fair and be seen as fair.

The cost of the process affects how disputes are handled

21.20 In December 1991, the Income Tax Act was amended to implement the "Fairness Package". Some of its provisions are meant to resolve disputes without recourse to the formal dispute resolution process; thus the Department expects the number of new objections to decrease. The package also aims to ease access for those who choose to use the formal process by extending the time limit to file an objection, removing the requirement to file objections on prescribed forms and allowing taxpayers to file objections at any NRT office.

21.21 Resolving disputes through the notice of objections process is relatively inexpensive. However, taking a case to court involves additional cost, and this cost could discourage taxpayers from pursuing their disputes. Only 37 percent of cases where the taxpayer disagrees with NRT's decision on an objection end up as appeals to the court. Cost is a factor from NRT's point of view too. However, the lack of a database on the cost of handling past cases limits NRT's ability to consider costs in current cases.

21.22 It is uncertain what effect recent amendments to the Tax Court of Canada procedures will have on taxpayers' readiness to use the Court system. Prior to 1991, taxpayers could choose to appeal either to the Tax Court or the Federal Court Trial Division. As of 1991, all new appeals have had to be handled first in the Tax Court under one of two procedures. The general procedure is followed unless, for cases involving assessments of up to $7,000 in federal tax and penalties, the taxpayer chooses the less costly informal procedure.

21.23 The cost of going to trial may be reduced or avoided if a settlement can be reached. NRT will settle cases where this can be done by negotiating an understanding with the taxpayer regarding the facts of the case. NRT cannot negotiate with respect to its interpretation of the law and established jurisprudence. In the United States, the Internal Revenue Service has more room to negotiate as it can also settle based on the probability of success in court.

21.24 Where a case may have important precedential value, NRT believes that the courts are the appropriate forum to resolve issues. In such a situation, the Department may offer to pay the taxpayer's costs of appeal, although it has no policy to this effect. The court has the option of awarding costs to the taxpayer.

NRT's organization is designed to enhance impartiality

21.25 Impartiality is enhanced where the divisions that originally make the decisions are separate from those that review the decisions.

21.26 The Appeals Branch has an organizational structure designed to enhance impartiality. The Branch is headed by an Assistant Deputy Minister, who reports directly to the Deputy Minister of the Department. The Chiefs of Appeals in field offices operate under the direction of this Assistant Deputy Minister and report to their local directors for administrative purposes only.

21.27 The Department does not rely solely on the separation of the Appeals Branch from the rest of NRT as a safeguard for impartiality. Appeals Branch officers have to communicate with auditors and assessors as well as taxpayers to obtain information. Therefore, NRT relies on the Branch's philosophy and training to instill an impartial state of mind in its officers and on controls within the Branch to ensure that there is an effective check on the dispute resolution process.

21.28 The Department maintains an operating manual, supplemented by directives and memoranda that contain policies, instructions and procedures for handling objections. These are intended to ensure that taxpayers are treated in accordance with the law. They provide the framework under which local Chiefs of Appeals review and approve files handled by their staff. Some chiefs also issue local directives.

21.29 Our review of a sample of completed and in–process objection files showed that, in general, the work met the requirements set out in the manual and other documents.

The Department is looking for better indicators of fairness

21.30 An organization that strives to provide service in a fair and impartial manner needs information on whether it is succeeding.

21.31 NRT's Part III of the Estimates contains two indicators of impartiality. First, the percentage of Tax Court judgments decided in the Minister's favour (about 74 percent) provides an outside party's judgment on NRT's position. However, the indicator covers only the small percentage of objections that have been appealed. In addition, NRT would have to define standards against which to judge results. For example, does 74 percent of judgments in favour of the Minister suggest a high enough level of impartiality?

21.32 The second indicator is the percentage of objections not appealed to the Tax Court. It averages about 93 percent. However, failure to appeal may not mean the decision has been impartial or even that the taxpayer agrees with the decision. A somewhat better indicator of impartiality would take into account the taxpayer's agreement with NRT's decision. NRT reports internally that for 1991–92, 75 percent of taxpayers agree with decisions.

21.33 Another approach to determining the extent of impartiality would be to ask taxpayers their perceptions of NRT's performance. The Department is developing a questionnaire to obtain client feedback on services provided by the Appeals Branch. The draft questionnaire asks, among other things, whether an officer has impartially considered the objection and whether the Department's position was clearly explained.

21.34 The Department should ensure that its taxpayer survey contains sufficient data to permit analysis of responses from selected subsets of taxpayers who dispute assessments, for example those who 'won' their cases versus those who 'lost'.

Department's response: *A major objective of Revenue Canada – Taxation is enhanced client service. Many methods such as surveys, client's correspondence, and comments from the field, to name a few, are used to measure client satisfaction. The Department is committed to refining its methods in gathering data to enhance our service delivery. In this context, we will pursue any meaningful opportunity to improve our information with respect to any client perceptions of our redress mechanisms.*

Timeliness

21.35 While undue haste would be counterproductive, neither taxpayers nor the Department would benefit from the uncertainty inherent in an overly long dispute process.

Inventory of objections in process is increasing

21.36 Over the last six years, the number of new objections filed by taxpayers has almost doubled, from about 33,000 to over 63,000 annually. A departmental study attributed this increase to both internal and external causes. These included the reaction to reassessments arising from enforcement actions, increased awareness of taxpayer rights, perceived slowness of the taxpayer–requested adjustments process, and complexity of the Income Tax Act.

Seventy–five percent of taxpayers agree with NRT decisions on objections.

21.37 The Department has been successful in acquiring most of its requested person–years to handle this increased workload of objections. Person–years have increased from 379 in 1986–87 to an expected 609 in 1991–92.

21.38 Although officers now resolve 57,000 objections each year, almost twice the number handled in 1986–87, they still resolve fewer objections than they receive. During these six years, the inventory of objections rose from 18,000 to over 38,000. The largest increase was in the pending category of inventory, which went from 9,300 to 21,500 objections. The Department attributes a portion of the increase to time lost during the Public Service labour dispute in the fall of 1991.

21.39 NRT aims to keep each field office's inventory of active objections that are over 120 days old below specified percentages based on the average complexity of the cases handled by that field office. Offices handling simpler cases have met their level of five percent in four of the last six years. However, the Department has not met its levels of 20 and 25 percent in field offices dealing with more complex cases.

NRT's measure of timeliness is incomplete

21.40 The average processing time to complete an objection has decreased from 11 hours in 1986–87 to under 9 hours today. In contrast, NRT reports that the average elapsed time to take an active objection from its consignment to a field office to completion has increased from 94 days in 1989–90 to 104 days for 1991–92. This varies with the complexity of the case, taking on average 77 days for the approximately 28,000 simplest objections and 399 days for the 136 most complex ones. If we included the time from the date the objection is first received from the taxpayer to the date it is consigned to the field office handling the case, the average age of objections would increase by more than a month.

It takes months before an Appeals Branch officer is assigned an objection and can begin working on it.

21.41 In effect, it takes months before an Appeals Branch officer is assigned an objection and can begin working on it. For active objections, over half of the elapsed time is consumed in obtaining the tax return, consigning it to a field office, and assigning it to an officer. Part of the remaining time could be taken up in awaiting responses from taxpayers. Thus, taxpayers have to wait more than four months on average for a decision on which an officer has had to do less than nine hours of work. About half the objections are in the simplest category and take an officer only about four hours of work; but the elapsed time for completion for these simple objections is still three and a half months.

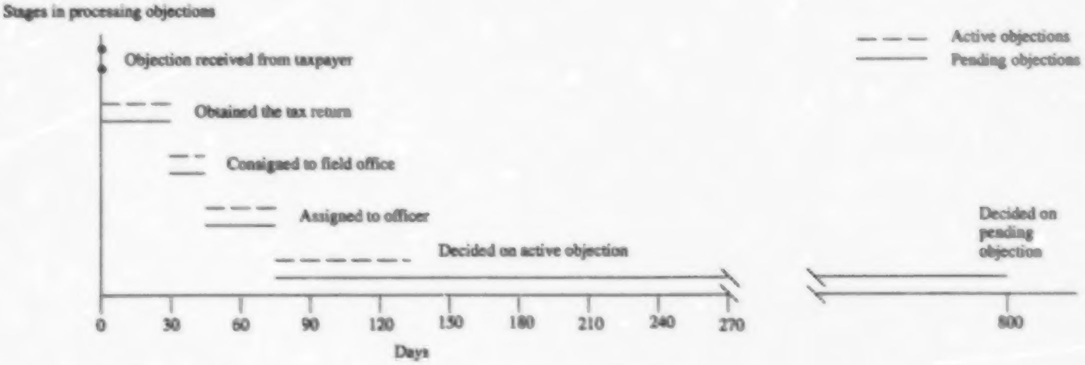
21.42 Further, NRT's goals and reports on timeliness leave out pending objections, which form over half of its inventory. Pending objections are those which are set aside to await the outcome of a similar dispute, a reply from the Appeals Branch head office, or information from another NRT division. Taxpayers can choose either to have their case dealt with as part of a group of similar cases in pending inventory or they can pursue it to the courts on an individual basis.

21.43 Once an objection is in the pending category, in particular if it is awaiting a court decision, the Department considers it outside the bounds of its goals for timely resolution of objections. However, over 25 percent of pending objections are referred to head office and to other NRT divisions. Although some of these objections may require outside expert advice, the Department can maintain much more control over cases pending for these reasons than it does over cases awaiting court decisions.

21.44 NRT records for 1991 showed that it took on average over 800 days for the completion of pending objections

Exhibit 21.3

Average Elapsed Time to Complete Stages in Processing Objections (1991)



Source: Departmental records

from the date they were received from the taxpayer. Over one quarter of these objections had been in process for more than three years. While there is some monitoring of pending objections awaiting court decisions, it can take months to resume processing of these pending objections after a decision has been reached on a related court case.

21.45 In meetings with NRT, various interest groups make comments on operational and technical issues and may even refer to the timeliness of the dispute resolution process. However, information on timeliness from this source is haphazard. The Department does not intend to collect taxpayer perceptions on timeliness systematically, such as by including a question on timeliness in the questionnaire mentioned in 21.33.

21.46 The Department should ensure:

(a) that management information contained in its quarterly reports covers the entire processing time for all types of objections – active, pending due to referrals internal to NRT and pending awaiting court decisions; and

(b) that its survey questionnaire asks taxpayers for their perceptions of timeliness of the dispute resolution process.

Department's response: *The Department currently uses several measures of timeliness to evaluate how quickly active objections are being processed. These measures start from when all the documentation necessary to work on an objection is available. We agree to expand this reporting to include the entire processing time for all types of objections.*

The various mechanisms presently used by the Department to gather information on client satisfaction will also be used to monitor feedback on the timeliness of the service offered by our Appeals function.

NRT and Justice are successful in handling an increased number of appeals and shorter time limits

21.47 At the beginning of 1991, NRT and Justice were faced with shorter statutory time limits under the amended Tax Court of Canada Act and an increasing workload of appeals. The new informal procedure (see 21.22) allowed the Minister only 45 days to reply to a notice of appeal and required the Court to fix a hearing date within 90 days of the due date of the reply. The number of appeals filed annually at all court levels had increased from about 2,600 in 1986–87 to over 3,300 in 1991–92. Most of these were appeals to the Tax Court, which grew by an average of 8 percent annually to reach 3,000 in 1991–92. The number of appeals filed in particular years varies, depending in part on the extent of appeals by groups of taxpayers.

21.48 NRT and Justice are taking steps to deal with this situation. Both departments have requested and received additional resources. They also provided information to field office staff about the Court changes months before they went into effect. NRT shifted a portion of the workload from its head office to its field offices. To assist in the processing of appeals, NRT took over a part of the work previously handled by Justice. Also, an interdepartmental task force was established in early 1991 to seek ways to handle appeals more efficiently and to reduce litigation. The final report, completed in early 1992, contained 74 proposals for change, a number of which are being implemented.

21.49 During 1991–92, 4,000 appeals were completed, over 1,000 more than in previous years. Part of this increase was due to the shorter time frames allowed under the Tax Court's informal procedures. Another part resulted from the efforts noted in the previous paragraph. A further part was due to the completion of cases on disputes involving appeals filed by groups of taxpayers.

Other Matters

Training of NRT personnel needs to be strengthened

21.50 Training is essential to ensure that all staff have the skills they need to carry out their work. This is particularly true in a decentralized organization in which staff are on rotational assignments and those who are new to the area take four to five months to become fully productive.

21.51 NRT rotates departmental staff into Appeals Branch positions in field offices to provide them with diversified experience. The rotation period depends on their classification level and the complexity of the cases assigned to them. The Appeals Branch looks for the most qualified people. Its field staff currently have an average of 12 years experience in the Department.

21.52 In May 1991, the Appeals Branch sought assistance from the Department's training centre to develop a more structured approach for training its officers. The first phase of this effort was a training needs analysis study completed in March 1992. The study's draft report expressed concern about disparities between training needs and the training currently available. The study recommended development of a training policy, training profiles outlining required courses and national training courses.

Appeals Branch provides feedback to other areas of NRT

21.53 Analysis of results of the dispute resolution process and its reporting to other areas of the Department contributes to improvements in operations.

Two thirds of changes or cancellations made by the Appeals Branch on disputed assessments are due to additional information provided by taxpayers. The rest result primarily from the identification of errors committed by assessors and auditors.

21.54 Two thirds of changes or cancellations made by the Appeals Branch on disputed assessments are due to additional information provided by taxpayers. The rest result primarily from the identification of errors committed by assessors and auditors. It is important that these results get back to their source to prevent similar situations from occurring in the future.

21.55 Appeals Branch distributes to field offices and other head office branches a quarterly statistical report containing summarized information. In addition, the Department recently arranged for access by audit divisions to information from the Appeals Branch automated information system on disputes related to assessments originated by audit. The Branch also provides NRT senior management with a list of the most frequent reasons that it changes assessments.

21.56 The several hundred cases referred each year to Appeals Branch head office result in a different type of feedback. When head office identifies a problem, it recommends changes in departmental policies and in the law to other areas of the Department.

21.57 An analysis provided to us by the Department indicated that most field offices rely on a variety of methods for feedback at the local level. Almost 60 percent rely on a combination of formal and informal feedback methods. Another 30 percent rely only on informal methods. The remaining field offices do not provide feedback. This analysis accords with our observations. During our interviews with some field office staff, we were told that auditors and assessors did not consider feedback helpful.

21.58 The Department should study the extent to which feedback is provided and used to improve operations and should develop recommendations for improving its use, where appropriate.

Department's response: *As the Auditor General's report indicates, Revenue Canada – Taxation has effectively used feedback to improve operations. Our feedback methods are continuously being evaluated with the* *view of improving their value to the organization.*

Further improvements in accountability information are possible

21.59 Part III of the Estimates is the key document by which departments report annually to Parliament. Part III should reliably, objectively and completely describe a program's objectives, plans, financial and human resources, standards and related performance. We found that NRT's 1992–93 Part III of the Estimates relating to the Appeals Branch showed some improvement over the previous years.

21.60 The Department is already collecting a great deal of information on the objections and appeals program. We believe that some information not currently reported would be useful to parliamentarians and others to obtain a clearer and more complete understanding of the program and its performance. The following are examples of information that should be available to parliamentarians. Where standards of performance exist, they should be included along with the results.

Decisions:

- number of objections resolved in favour of the taxpayer
- number of objections resolved with the agreement of the taxpayer
- number of appeals resolved in favour of taxpayer without going to court

Timeliness:

- average elapsed time to resolve objections
- average age of the inventory of unresolved objections

Workload:

- breakdown of the inventory into active and pending objections
- sources of objections workload

Dollars:

- dollar value of assessments in dispute (currently reported under the Collections program)
- dollar reduction of assessments for resolved objections and appeals

21.61 The Department should ensure that more detailed and complete information on fairness and timeliness is made available to parliamentarians. This more detailed operations information ought to be compiled, referred to in the Part III and made available to parliamentarians on request.

Department's response: *As noted, the Department has already taken measures to improve Part III of the Estimates relating to the Appeals Branch.*

Furthermore, we are in the process of developing key performance indicators for the Appeals program, as well as for other major programs in the Department. Though these indicators are primarily intended to monitor and manage programs, those of potential interest to parliamentarians and the public will also be reported in Part III of the Estimates.

In addition, the Department currently responds to requests for a variety of information on the Appeals program, from professional organizations, MPs and the general public, and remains committed to doing so in the future.

Chapter 22

Royal Canadian Mounted Police

Provincial and Municipal Policing

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Royal Canadian Mounted Police

Provincial and Municipal Policing

Assistant Auditor General: David Rattray
Responsible Auditor: David Brittain

Main Points

22.1 **A long–standing partnership.** Through contractual arrangements the RCMP has, for decades, served as the provincial, territorial and municipal police in eight provinces (not Ontario and Quebec), the two territories and 191 municipalities. This long–standing partnership has stood the test of time and has conferred significant benefits on all parties involved.

22.2 **Operational efficiency.** The RCMP could improve its efficiency if more of its detachments would implement a "differential response strategy", and adopt a more efficient shift schedule. It also needs to make greater use of available technology and to improve the efficiency of its report writing. In addition, it should improve its performance measurement practices and rectify the problems associated with its management information systems.

22.3 **A new focus — community–based policing.** Over the last few years, a shift has occurred in policing philosophy that puts a much greater emphasis on community consultation and problem solving. The RCMP has been able to progress in a number of aspects of community–based policing, such as starting to hire visible minorities and establishing a community and aboriginal policing directorate. There are some delays, however. The Force has not developed guidelines that suggest how to better involve the community and improve local police operations. It is still in the process of adjusting its recruitment, training and other personnel policies and practices to match the needs of the new philosophy.

22.4 **Sharing the cost.** The federal government historically has never recovered the full cost of providing contract policing services because it believes that it receives certain benefits from the arrangement. The 1992 contract has added certain items to the negotiated cost base, according to which the provincial and municipal share of the costs is determined. The addition of these items means that the new negotiated cost base reflects more closely the actual cost to the federal government. We estimate, however, that there is a gap between the negotiated cost base and the actual cost, ranging from $100 million to $150 million. We are concerned that these actual cost figures are not clearly disclosed to Parliament. Furthermore, we believe that, when the contract is reviewed in five years, the federal government should attempt to negotiate from a cost base that includes all actual cost elements.

Background

22.5 To many Canadians, the image of their country includes the RCMP and its historical role of policing the North and the West. The RCMP has been acting as the police force in numerous parts of Canada for many years. Its first provincial contracts were with Alberta and Saskatchewan in 1906, and the first municipal contract was with Flin Flon, Manitoba, in 1935. Today, it polices all provinces (except Ontario and Quebec), the two territories and 191 municipalities. In effect, the RCMP provides local police services to approximately 75 percent of the country's land mass and to about 20 percent of its population.

22.6 About 9,800 RCMP personnel — approximately half of the Force total — are involved directly in contract policing services. Most (80 percent) of these are uniformed RCMP members, while the rest is a mix of civilian members and public servants. Exhibit 22.1 shows the distribution by province.

22.7 Contract policing services are delivered through 641 detachments distributed among those provinces, territories and municipalities that contract for RCMP police services. At detachments, members perform general policing duties such as patrolling their areas, responding to calls for service, enforcing traffic and liquor control laws and municipal by–laws, investigating criminal cases and carrying out crime prevention activities. They are also responsible for enforcing federal statutes such as the Narcotics Control Act and Canada Shipping Act. Exhibit 22.2 shows the other levels of the organization and their respective functions.

22.8 As shown in Exhibit 22.3, in 86 percent of the detachments there are fewer than 20 uniformed members. They serve small rural communities such as Souris, Prince Edward Island and Fort St. James, British Columbia; remote areas such as Reliance, Northwest Territories and Nain, Newfoundland; and aboriginal communities such as Assumption, Alberta and Shamattawa, Manitoba. Larger detachments, each with 20 to 100 members, police small cities such as Kamloops, British Columbia and Red Deer, Alberta. The largest RCMP detachments are in the suburbs of Vancouver. The Surrey and Burnaby detachments each have more than 200 members and face the same challenges as police departments in any large Canadian city.

A long–standing partnership that has served all parties well.

The contract policing arrangement is a long–standing, mutually beneficial partnership

22.9 Contract policing arrangements represent a long–standing partnership and now involve more than 200 entities at three levels of government. It is a relationship that has worked and has served all parties well. A number of indicators suggest that the arrangements have been satisfactory:

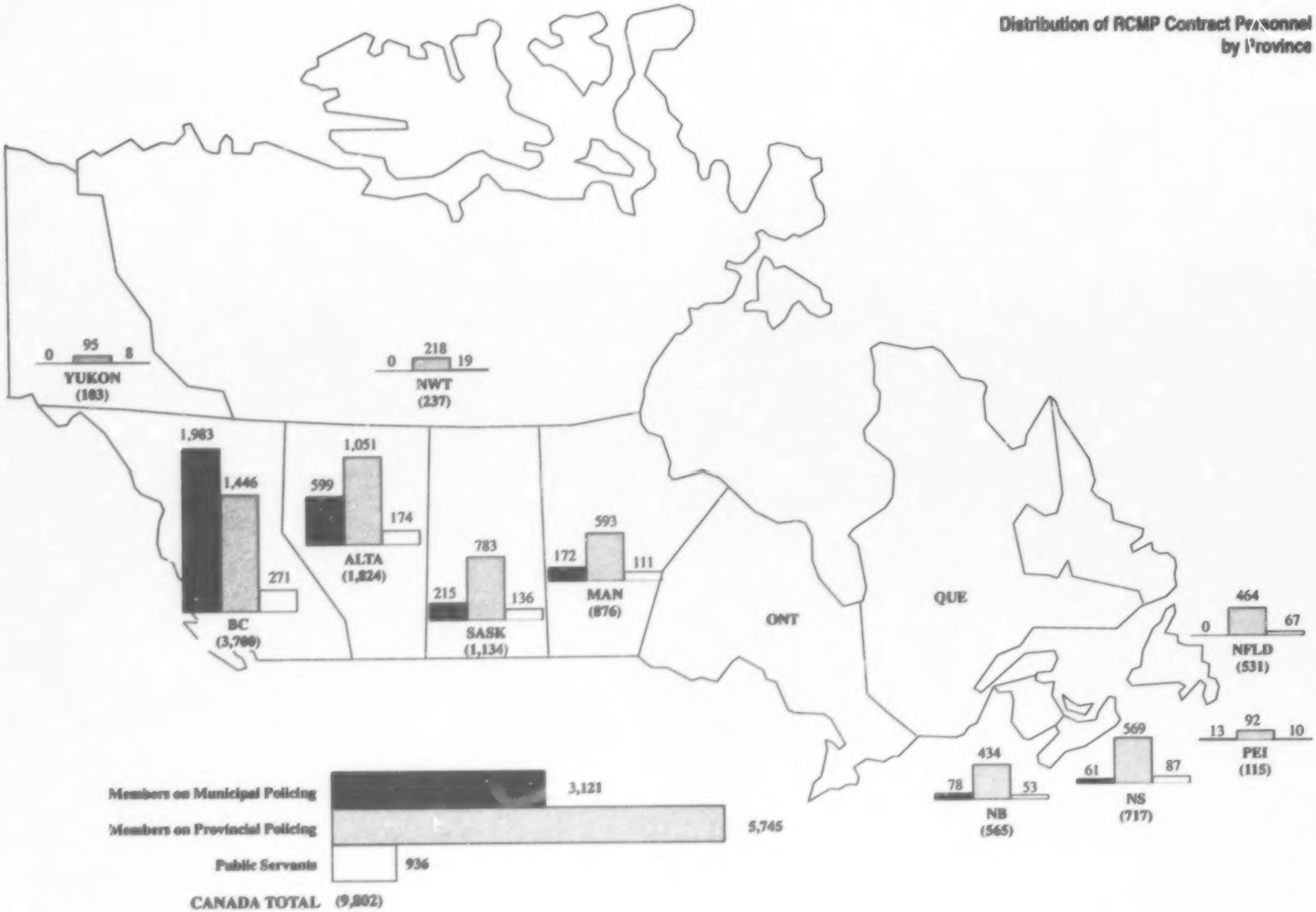
- The partnership has lasted for a long time.
- New Brunswick returned responsibility for highway policing to the RCMP when the New Brunswick Highway Patrol was disbanded in 1989.
- In the recent contract negotiations, the provinces and municipalities agreed to a contract term of 20 years instead of the 10–year term originally offered by the federal government.
- Feedback was positive from officials and elected representatives at all levels whom we interviewed during the audit.

22.10 A number of benefits have accrued to the federal government from the arrangement:

- It has a national police force with experience in provincial and municipal policing.

Exhibit 22.1

Distribution of RCMP Contract Personnel
by Province


0
95
8
YUKON
(103)
0
218
19
NWT
(237)
1,983
1,446
271
BC
(3,700)
599
1,051
174
ALTA
(1,824)
215
783
136
SASK
(1,134)
172
593
111
MAN
(876)
ONT
QUE
0
464
67
NFLD
(531)
13
92
10
PEI
(115)
61
569
87
NS
(717)
78
434
53
NB
(565)
Members on Municipal Policing
3,121
Members on Provincial Policing
5,745
Public Servants
936
CANADA TOTAL
(9,802)

- The working relationship with other provincial and municipal police forces facilitates the RCMP's federal policing role.

- The RCMP is able to draw on its pool of provincial and municipal officers for national emergencies and special events.

- Provincial and municipal policing is an excellent training ground for new RCMP officers.

22.11 The provinces and municipalities have benefited from the relationship:

- They receive police services that are consistent across the province and with neighbouring provinces.

- They have a well–recognized police force at less than actual cost.

- They have a police force that is independent and objective.

The changing environment represents an opportunity for renewal

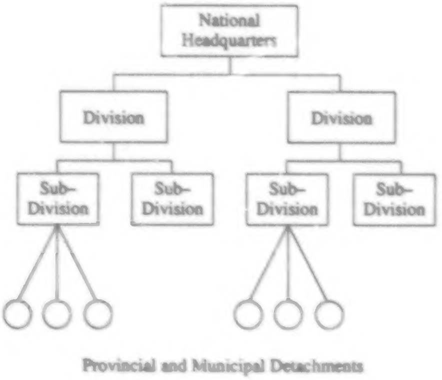
22.12 In the last few years, external forces such as the increasing and aging Canadian population, changing ethnic mix and other socio–economic and technological factors have changed the nature of crime and increased the demand for police services. In the meantime, fiscal restraint at all levels of government has put pressure on police budgets, which, for municipalities, may consume a significant proportion of their annual expenditures. The demand for greater fiscal accountability is matched by a growing demand for the police to account for their conduct.

22.13 Pressure is also increasing internally for the police to improve the way they work. A shift has occurred in the approach to policing. In addition to law enforcement and crime control, there is now a greater emphasis on crime prevention and problem solving.

22.14 Many police departments see the pressure to change as an opportunity for organizational renewal. It has caused them to re–examine a number of fundamental issues, such as the proper role for police in society and how police services can be improved without hiring more people or increasing budgets. One of the most popular initiatives in North America is to adopt a concept commonly referred to as "community–based policing". However, both in concept and in practice, community–based policing may differ from jurisdiction to jurisdiction.

Exhibit 22.2

RCMP's Organizational Structure for Delivering Contract Policing Services



Number	Function
1	Departmental Administration
10	Divisional Administration
46	Communications Centre Field Identification Special Units
641	General Policing Traffic Enforcement Criminal Investigation Crime Prevention

Exhibit 22.3

Distribution of Uniformed Members by Detachment Size

Size of Detachment	No. of Detachments	Percent	No. of Uniformed Members	Percent
1 to 20	549	86	3,514	45
21 to 100	85	13	3,199	40
more than 100	7	1	1,163	15
TOTAL	641	100	7,876	100

22.15 Introducing the concept will require the police to make significant operational and organizational changes. First, they will have to modify their methods and processes to improve their efficiency and effectiveness. For example, the incident–driven, reactive police response strategy may be changed to a problem–solving approach where the police work with the community to identify and resolve the root causes of incidents. Other pro-active measures, such as directed patrol and crime prevention, could be expanded. In addition, assignment of specific communities to individual officers could become the norm, and a team approach could be encouraged.

A RCMP detachment in the North ...

and in a suburban area ... (see paragraphs 22.8).

22.16 Second, authority and responsibility may have to be delegated to the lowest level possible. Front–line managers will need to have the authority to make decisions based on local conditions and needs. The number of command levels may be reduced, and the distribution of authority adjusted. Instead of one–way, downward communication, feedback from the bottom up will be encouraged. Strict adherence to procedures may need to be relaxed. Innovation and initiative will be encouraged and rewarded.

22.17 Finally, the changes at the operational and organizational levels discussed above will create a new "culture" (organizational values). Accordingly, existing performance evaluation standards and the reward system will have to be overhauled to ensure that they reflect and support the new values.

22.18 In his 1989 Directional Statement, the Commissioner committed the RCMP to adopting the community–based policing concept. To the RCMP, community–based policing "means the police and the community working together to identify and resolve crime and social order problems of communities. This style of policing recognizes that communities have an essential role to play in police decision–making. This role includes joint problem–solving, priority–setting and formulating requests for service that influence the attitudes of members and the delivery of policing services. Under this operating framework the police are directly accountable to the community and community concerns must therefore form an integral part of an operational plan at a detachment." When fully implemented, this new concept will significantly affect the way the RCMP carries out its contract policing services.

Audit Objectives and Scope

22.19 When we started our audit the RCMP had just begun to implement its various strategic action plans. We decided to examine both how the RCMP operates today and how it is preparing for tomorrow.

22.20 We visited selected RCMP detachments to observe police operations, and we reviewed the related management systems and practices at divisional and national headquarters. Our audit objectives were to examine:

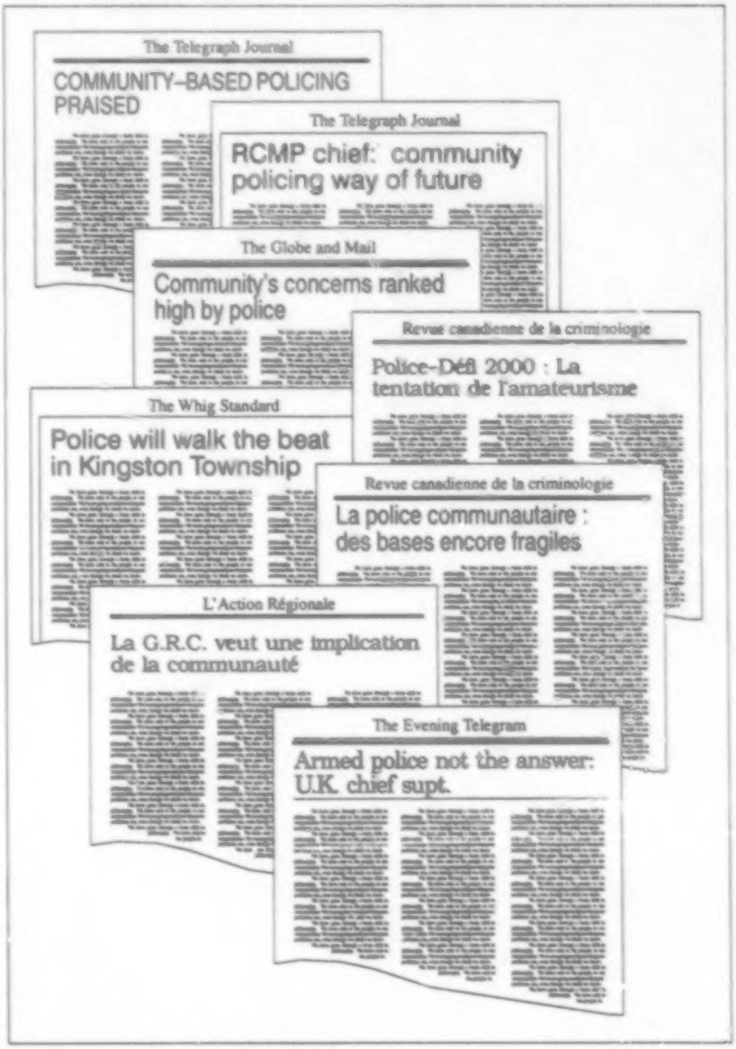
- how the RCMP detachments relate to the communities they serve;
- whether the RCMP delivers policing services economically and efficiently; and
- whether management systems and practices are adequate to support the delivery of high–quality policing services.

22.21 We then looked at the RCMP's efforts to implement the concept of community–based policing. Our objective was to determine whether it has organized and managed various projects associated with community–based policing to ensure the achievement of its 1993 target date for implementation.

22.22 The provinces and the federal government recently concluded a new contract policing agreement that changed the way the two parties share the cost of contract policing. We reviewed the cost analyses conducted by the RCMP in support of contract negotiations. We also examined accounting and billing operations in relation to the recovery of costs, and looked at the disclosure of cost information to Parliament.

Policing Operations — There Is Room to Improve Efficiency

22.23 Exhibit 22.4 outlines the sequence of events that typically occur in a police department when a call for service is received. As the nature and pattern of crime differ from area to area, the police must analyze crime statistics, call patterns, changing demographics, ethnic mix and econ-



The Telegraph Journal

COMMUNITY–BASED POLICING PRAISED

The Telegraph Journal

RCMP chief: community policing way of future

The Globe and Mail

Community's concerns ranked high by police

Revue canadienne de la criminologie

Police-Défi 2000 : La tentation de l'amateurisme

The Whig Standard

Police will walk the beat in Kingston Township

Revue canadienne de la criminologie

La police communautaire : des bases encore fragiles

L'Action Régionale

La G.R.C. veut une implication de la communauté

The Evening Telegram

Armed police not the answer: U.K. chief supt.

Widespread acceptance of the community–based policing concept (see paragraph 22.14).

Growing demands for service on the one hand and fiscal restraint on the other are putting pressure on the police.

omic activities in its jurisdiction to determine what policing methods best serve the needs of the community.

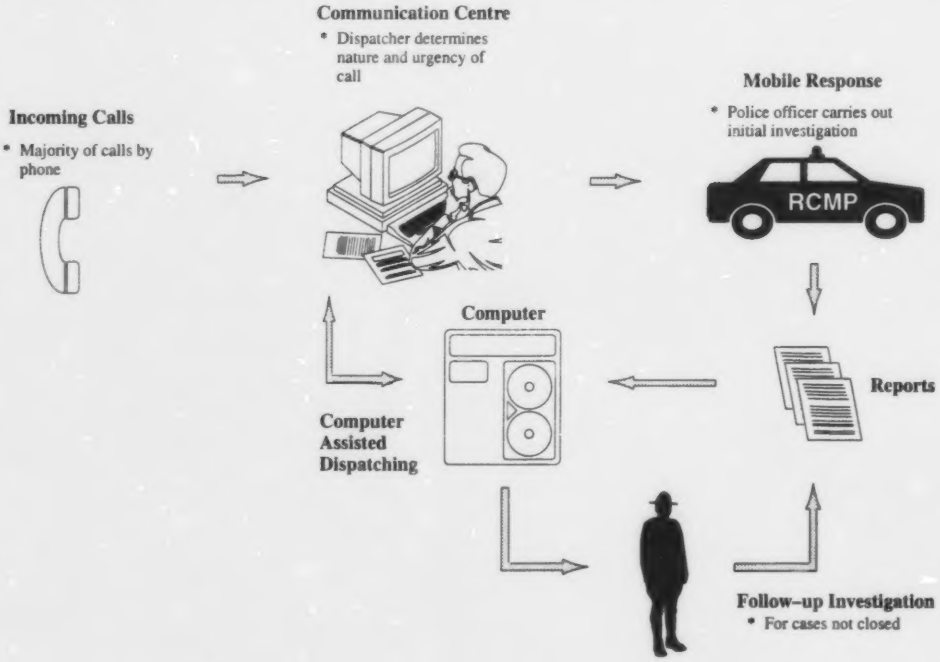
22.24 The need to match methods with communities suggests that, in each of its 641 detachments, the RCMP must tailor its operations to meet very specific local requirements. At the same time, however, as a national force the RCMP must also maintain a degree of uniformity throughout Canada. The delicate balance between maintaining national standards and central control and allowing detachments to make certain decisions based on local needs poses a major challenge to the Force.

22.25 With growing demands for service on the one hand and fiscal restraint on the other, the police are feeling pressure to improve the way they operate. Improvements can be divided into two types: process improvements and technological improvements. Process improvements may include finding better ways to manage calls for service, scheduling staff so that police resources are more closely matched to demand for service and simplifying case–reporting requirements. Technological improvements may include developing computerized dispatching systems, installing mobile digital terminals and cellular phones in police vehicles and using portable computers for writing reports.

22.26 However, the RCMP often cannot make the changes on its own. Contract agreements require that the RCMP consult with the provinces and municipalities if operational changes will affect the level of police service in the jurisdiction. Another factor that the RCMP must consider is the availability of funds. Any changes in operations or introduction of new technologies that require additional funding approvals from the provinces and municipalities

Exhibit 22.4

Typical Sequence of Events in a Police Department


Communication Centre
• Dispatcher determines nature and urgency of call
Incoming Calls
• Majority of calls by phone
Mobile Response
• Police officer carries out initial investigation
RCMP
Computer
Reports
Computer Assisted Dispatching
Follow–up Investigation
• For cases not closed

have become more difficult in recent years.

Responding to Calls for Service

22.27 Some recent studies have shown that approximately 15 percent of calls the police receive are either crimes–in–progress or other emergencies that require an immediate response. Another 55 percent are non–emergencies, such as minor thefts, to which the police must respond, but not necessarily immediately. The remaining 30 percent are minor cases such as lost–and–found or minor traffic accidents that need not necessarily be handled by a police officer. Instead, they can be dealt with by a civilian over the phone, or by asking the caller to file a report either at the police station or by mail. Exhibit 22.5 illustrates this concept of differential response.

22.28 Many police departments across Canada have analyzed their call statistics and patterns and have implemented a differential response strategy, which allows them to respond to calls in more cost–effective ways. For example, some police departments no longer attend minor motor vehicle accidents if there are no injuries and if traffic is not obstructed. In some larger cities, police officers do not attend minor break–and–enter cases when the value of the stolen items is under $1,000, unless a suspect or physical evidence is present. This may not be as easy for the RCMP because the perception of what constitutes an offence and how it should be handled may vary significantly from one community to another.

22.29 To reduce the amount of time it spends on minor occurrences, the Ontario Provincial Police has instituted a differential response strategy in the 70 percent of its detachments where it was felt to be appropriate. In 1990 the Provincial Auditor of Ontario reported that the system had resulted in a better deployment of police resources, which allows detachments to focus on more important and urgent police functions.

Better management of calls could improve the deployment of RCMP resources

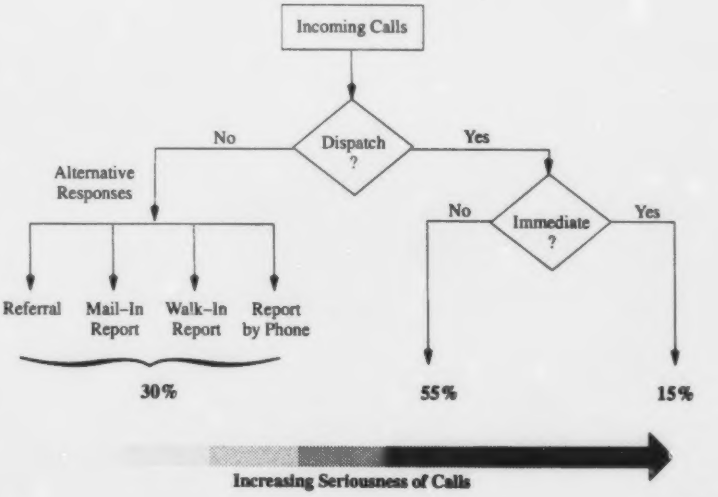
22.30 We noted that several RCMP detachments use some elements of a differential response strategy. However, they had introduced the strategy only on an ad hoc basis, mainly because they could no longer cope with the demand for service with the resources available. At the time of our audit, most detachments still responded to virtually all calls, according to priority, by dispatching a police car.

22.31 Without a differential response strategy, uniformed members may be spending a large amount of their time responding to and investigating minor cases, and not directing resources to more important cases or to other more productive community–based policing activities.

22.32 There are valid reasons why the RCMP has not adopted a differen-

Exhibit 22.5

The Concept of Differential Response Strategy



tial response strategy at all its detachments. First and foremost, the RCMP cannot do so on its own; contract agreements require that provincial and municipal officials be consulted in determining the minimum level of police service. Second, the RCMP has a long tradition of satisfying every demand for service to the greatest extent possible.

22.33 The RCMP should develop guidelines and criteria for determining when a differential response strategy would be appropriate.

RCMP response: *Agree. Differential response is central to the community policing service delivery model and is being addressed as part of that initiative.*

22.34 The RCMP should instruct its detachments to study the feasibility of adopting a differential response strategy in their jurisdictions. Based on the results of these studies, it should then consult with the appropriate provincial and municipal officials to determine whether a differential response strategy is feasible and appropriate in a particular jurisdiction.

RCMP response: *Agree. This is also a step in the implementation of community–based policing.*

Scheduling of Shift Work

22.35 The number of crimes and calls for police service changes from hour to hour. Scheduling of equal numbers of officers at all times of the day, without regard to the demand for service, can be wasteful and costly. In fact, no single schedule pattern is the "best". Accordingly, police departments across Canada use a wide range of schedules to meet particular conditions (see Exhibit 22.6).

22.36 To avoid inefficient scheduling, the RCMP's policy on work scheduling prescribes a proportional distribution of human resources (PDHR) method. This method helps detachment commanders to schedule their police officers according to the demand for service. The principles of this method are logical and consistent with those practised by other police departments.

22.37 We applied the PDHR method to the workload statistics of two RCMP detachments shown in the top two diagrams of Exhibit 22.7. In using it, we were able to match resources to fluctuating demand reasonably well, as shown in the middle two diagrams.

Shift schedules in certain large RCMP detachments do not correspond to workload

22.38 However, we found that many large RCMP detachments with similar fluctuations in demand for service did not follow the PDHR method. Instead, they were operating on a 12–hour and "equal–watch" schedule. That is, while each police officer worked a 12–hour shift, equal numbers of police officers were on duty 24 hours a day, seven days a week, all year round. As can be seen in the two bottom diagrams of Exhibit 22.7, under an equal–watch arrangement officers may not be available in sufficient numbers to handle the calls.

22.39 The RCMP's policy on work scheduling requires that detachment commanders — before proposing any extended shifts — assess how these shifts may affect the level of service to the public, members' morale, overtime and other administrative functions. The policy also states that the commanding officers must be satisfied that extended shifts will not compromise the delivery of police services.

22.40 Most of the large RCMP detachments that work on the 12–hour and equal–watch schedule have been doing so for many years. The RCMP could not provide us with documented approvals for these schedules. We only found a few quantitative assessments to support recent requests for extended shifts, as the policy requires. Approvals have often been granted solely for their assumed positive effect on members' morale, to compensate for the fact that the members put in a large amount of voluntary overtime and are not unionized.

22.41 Because the equal–watch schedule is easy to manage and members generally prefer 12–hour shifts, there is a tendency to accept it without considering its effects on efficiency and on the quality and level of service provided. This is an issue that the RCMP has been aware of and has studied for some time; there are always trade–offs between morale and efficiency. Given the current fiscal constraints at all levels of government and the focus on meeting community expectations, the RCMP will need to balance members' morale with operational efficiency in approving various shift schedules.

22.42 The RCMP should ensure that detachments comply fully with its policy on shift schedules. It should also add to the policy a requirement that existing schedules be evaluated periodically.

***RCMP response:** Agree.*

22.43 The RCMP should assess the suitability of the 12–hour and equal–watch schedule used in the large detachments, in particular the "equal watch" aspect.

***RCMP response:** Agree. A study will be undertaken and appropriate changes made to address this recommendation and that contained in 22.42.*

The Dispatching Function

22.44 Using modern computer technology, most medium–to–large police departments across Canada have automated their dispatching and other systems. However, the task of automation is not as simple for the RCMP as it is for other departments, because it operates in a diverse environment ranging from populated urban areas to widely dispersed remote communities. Systems designed for municipal operations may not be suitable for rural areas.

22.45 Developing technology to support operational needs is a national headquarters responsibility. There is a three–stage master plan for information technology in the Force. The first stage is to develop a national police database; the second stage is to upgrade its dispatching systems; and the third stage is to introduce other related equipment. The overall approach has

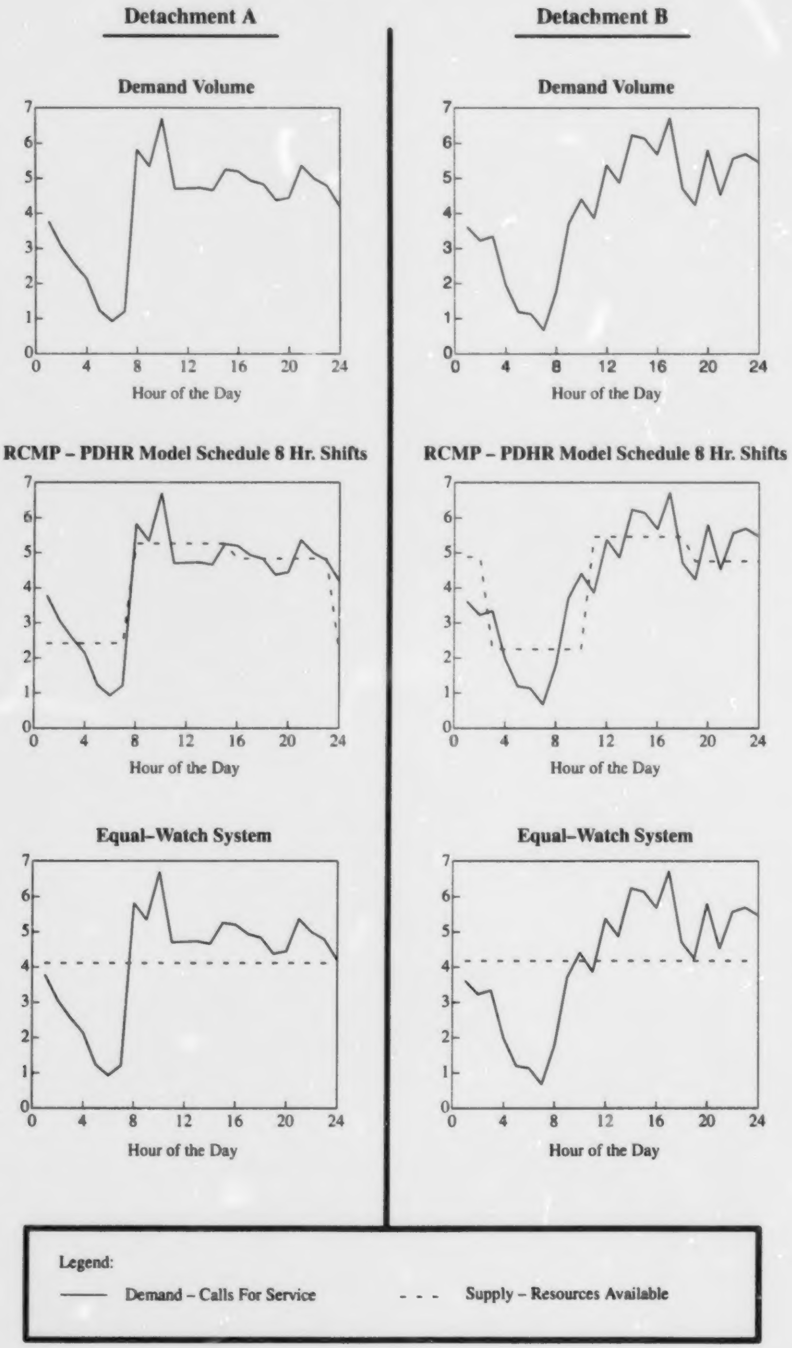
Exhibit 22.6

Shift Schedules Used in 22 Canadian Police Departments
(Source: D. Baxter, K. Hahn and S. Holmes, Univ. of Waterloo, 1990)

Police Force	Lengths	Rotation Patterns
Victoria, B.C.	12-Hour	2-Days/2-Nights/4-Off
Vancouver, B.C.	10-Hour	4-On/3-Off
Calgary, Alta.	10-Hour	105-Day Cycle
Edmonton, Alta.	10-Hour	9-Week Cycle
Saskatoon, Sask.	12-Hour	2-Days/2-Nights/4-Off
Regina, Sask.	12-Hour	28-Day Cycle
Winnipeg, Man.	10-Hour	28-Day Cycle
London, Ont.	8, 9 and 10	105 Day Cycle
Waterloo, Ont.	8 and 10	35-Day Cycle
Peel Region, Ont.	8 and 10	35-Day Cycle
Metro Toronto, Ont.	8 and 10	35-Day Cycle
Kingston, Ont.	8 and 10	35-Day Cycle
Ottawa, Ont.	8 and 10	35-Day Cycle
Quebec City, Que.	9-Hour	35-Day Cycle
Montreal, Que.	8.5-Hour	35-Day Cycle
Fredericton, N.B.	12-Hour	2-Days/2-Nights/4-Off
Saint John, N.B.	10-Hour	24-Day Cycle
Dartmouth, N.S.	12-Hour	8-Day Cycle
Halifax, N.S.	12-Hour	2-Days/2-Nights/4-Off
Summerside, P.E.I.	12-Hour	8-Day Cycle
Charlottetown, P.E.I.	8-Hour	49-Day Cycle
St. John's, Nfld.	8-Hour	21-Day Cycle
RCMP Units		
Large Detachments	12-hour	2-Days/2-Nights/4-Off
Small Detachments	8 or 10	pattern varied

Exhibit 22.7

Comparison of Two Different Shift Schedules in Two RCMP Detachments



been to develop standard systems for use throughout the Force.

The RCMP needs to modernize its dispatching systems

22.46 The first stage of the plan was accomplished with the development of the Police Information Retrieval System, for which the requirements at all detachments are similar. However, the Force is still developing dispatching systems and introducing other related equipment to meet the requirements of its largest detachments, mainly in British Columbia.

22.47 The RCMP has one Communication Centre (Comm–Centre) in each subdivision to service all detachments under its command. During regular hours, these detachments dispatch their own police cars. After hours, the responsibility is switched over to the Comm–Centre. In these centres, the RCMP dispatchers generally communicate by radio with police officers on patrol, and they use paper and pencil to keep track of police vehicles on the road. However, the five largest detachments in the lower mainland of British Columbia each have their own Comm–Centre, operating 24 hours a day. These centres are equipped with a computer–assisted dispatching (CAD) system, which the RCMP installed in 1976.

22.48 In 1982, the RCMP started to plan the development of the Computerized Integrated Information and Dispatching System (CIIDS) to replace the CADs in the lower mainland, which the RCMP said it considered to be obsolete (see Exhibit 22.8).

22.49 Several factors have affected the development of CIIDS:

- The RCMP has had to develop a system from the ground up because it needed to link with Canadian Police Information Centre and Police Information Retrieval System, which were already in operation. This decision effectively precluded adopting a commercially available system.
- The Force has chosen to develop a standard system to meet a range of local operational needs, to achieve significant cost savings. This approach makes the system more difficult to design and develop.
- There were unexpected local requirements during the development period, such as the introduction of a 911 system and the advent of new computer technologies.

22.50 The design, development and installation of CIIDS has taken almost ten years. Today, the largest RCMP detachments in the lower mainland of British Columbia are still operating without modern dispatching systems and communication equipment such as mobile data terminals, which many large–city police departments in Canada have had for some years. This impacts on operations in two ways. First, the voice communication on the old CADs has occasionally impeded speedy response to calls and affected the efficiency of service. Second, the RCMP intends to use CIIDS to reduce 60 percent of the number of reports that need to be handwritten. Without CIIDS, the members are spending more time than necessary on paperwork. The

Police departments are making more use of automated systems to handle calls for service.

A typical Comm–Centre in the RCMP (see paragraph 22.47).

impact of the resulting lower operational efficiency is most significant at these larger and busier locations (See Case Reporting below for further details).

22.51 The RCMP should complete the development of the Computerized Integrated Information and Dispatching System and ensure its installation in the lower mainland of British Columbia as quickly as practical. It should introduce, where appropriate, other related equipment such as mobile digital terminals at the same time as CIIDS is installed.

RCMP response: Agree. This recommendation will be implemented depending upon the availability of resources.

22.52 The RCMP's original plan was to install CIIDS in other selected Comm–Centres based on a year–by–year review and approval of resourcing for each phase. In 1990, the Comm–Centres in New Brunswick were amalgamated into one. Recently, there were discussions in both Alberta and British Columbia to reorganize the present Comm–Centre structures. We believe that this trend could further improve operational efficiency and reduce capital requirements. Given the fiscal situation at all levels of government today, the RCMP needs to carefully assess the costs and benefits before proceeding with each CIIDS installation.

22.53 In seeking to improve its dispatching operations, the RCMP should investigate various alternatives such as the amalgamation of communication centres and the installation of the Computerized Integrated Information and Dispatching System, and it should base its decision on the costs and benefits of each alternative.

RCMP response: Agree, with the conditions that human life and safety, and community satisfaction will also be taken into consideration with costs.

Case Reporting

22.54 Information is of critical importance for police operations, from the moment a call is received until a case is concluded. Information is gathered at various stages, stored in different media and retrieved for use by police personnel. However, over time, information — particularly in written form — has become a burden for the police. Recently, modern technologies such as information retrieval systems, mobile data terminals, portable computers and cellular phones have become available to improve the way the police handle information.

22.55 During our audit, we visited a number of police departments across Canada to see how they were dealing with the information issue. Exhibit 22.9 shows three of these cases.

22.56 Typically, improvements occur in two stages or steps. The first step is to reduce the amount of reporting that is required. This step involves "operational" decisions. For example, a decision might be taken to adopt procedures (such as differential response strategies) that could reduce the number of reports to be written. Criteria defining whether a case should be pursued beyond the initial investigation could also be developed, which might reduce paperwork.

22.57 Once the operational decisions have been taken, the second step is to adopt appropriate technologies to improve efficiency. Here, technical

Exhibit 22.8

Major Events of CIIDS

Preliminary Analysis Report	December 1982
Planning Phase Report	March 1983
System Specifications	September 1986
Request for Proposal	April 1987
Treasury Board Approval	April 1988
Contract Awarded	November 1988
Prototype Testing at Red Deer	July 1990
Testing of Full–scale System at Burnaby	May 1992
Full–scale Installation at Burnaby	November 1992 (planned)
Implementation at Rest of Lower Mainland	1993–94 (planned)

experts and police officers need to work closely together as a team to develop the best technology to meet operational requirements, which are often dictated by local conditions.

The RCMP's members spend a significant amount of time writing case reports

22.58 From discussions with RCMP members at various locations, on certain days they can spend up to 50 percent of their working hours writing reports, including both case–related and administrative reports. Members put in a large amount of voluntary (unpaid) overtime writing reports, typically at the end of their shifts. The RCMP informed us that its contract policing personnel contributed over one million hours of voluntary overtime in 1991.

22.59 Some of these case–reporting requirements are internal to police departments, enabling them to better manage their operations. Others are externally imposed to meet the needs of legislation such as the Charter of Rights, Access to Information and public complaint processes. Exhibit 22.10 shows the forms and reports required in an impaired driving case, and who requires them. Changes to reporting requirements are often outside of the RCMP's control.

22.60 With more than 7,000 uniformed members involved in contract policing, the potential to realize productivity gains by reducing the time spent on writing reports is significant. For example, if the time could be reduced by as little as four percentage points, as the police department in case study 2 of Exhibit 22.9 was able to do, the RCMP could theoretically free up to an equivalent of 280 officers from report–writing tasks to work on crime prevention, directed patrol, and other community–based policing activities.

22.61 We compared the case reporting practices of the RCMP with other police departments and found a number of factors that help to explain why RCMP uniformed members have to spend so much of their time writing reports.

Case reporting can be a burden.

22.62 First, the RCMP requires its members to prepare a written report for every case to which they are dispatched because, unlike other major police departments, the RCMP has no capability to create case files automatically through its dispatching systems. It follows that RCMP officers have to handwrite reports on minor cases.

22.63 Second, police officers in the RCMP provincial detachments are required to perform routine clerical tasks such as typing investigative and administrative reports, because these detachments have, on average, only one civilian support staff for every six police officers. In its municipal detachments, where the support staff are paid

Exhibit 22.9

How Three Police Departments Have Improved Their Case Reporting Operations

Case 1 – Reporting Minor Cases

The police department of a large Canadian city decided to stop filing reports on minor cases. It also established a civilian telephone response unit to take reports over the phone. Alternatively, citizens were asked to file a report at an information desk in the police station. These changes have greatly reduced the number of reports that police officers have to write.

In 1990, of the 200,000 calls for police service this department received, 130,000 were classified as minor cases, requiring no written occurrence report. The remaining 70,000 calls resulted in occurrence reports. Furthermore, 28,000 of these reports were prepared by civilians at the information desk and telephone response unit. As a result, police officers had to prepare only 42,000 written reports, which freed a substantial amount of time for other tasks.

Case 2 – Direct Data Entry

In the mid–1980s, a regional police department carried out a feasibility study on implementing a direct data entry system. The study revealed that police officers in the organization spent, on average, 17 percent of their time writing reports. It concluded that it would be beneficial to implement a system whereby a police officer could call in and dictate the information to a clerk at the police station, so that the report could then be directly entered into a computer.

Two years after the implementation, the department conducted an evaluation and found that the amount of time police officers spent on report writing had decreased to 13 percent, i. e. a net reduction of 4 percent. This was equivalent to adding approximately 30 police officers to the department.

Case 3 – Use of PIRS

There are presently 13 independent police departments in Canada using the RCMP's Police Information Retrieval System (PIRS) to keep case reports. Some of these departments have made innovative use of PIRS to reduce report–writing burden on police officers.

For example, in a police department in western Canada, the dispatcher enters directly into PIRS the details of each incoming call, and dispatches a police officer according to priorities. For minor cases, the officer radios the outcome of investigation to the dispatcher and concludes the file directly on PIRS. In 1991, of the 10,000 calls received by the department only 20 percent required handwritten reports from police officers.

by the municipalities, that ratio is about one to three — the same ratio as in other police forces. We were informed by the RCMP that it could not hire more civilian support even if it were prepared to exchange police officers for civilian staff, because there has been a general hiring freeze in the federal public service. The "operating budget" concept, which allows RCMP management more flexibility and is currently being introduced on an experimental basis, may help to reduce this recognized problem.

22.64 Third, the use of new technology for case reporting in large RCMP detachments is much more limited than it is in most other large police departments in Canada. In most cases, RCMP members have to handwrite their reports first, and then give them to a clerk to enter into the computer. The RCMP has begun to introduce, or to test the feasibility of adopting, other modern technologies such as mobile data terminals, portable computers and electronic notebooks at various locations.

22.65 In the last few years, police departments across Canada have established "paperless" reporting systems to reduce paper burden. They allow minor cases to be concluded on their computerized systems without any paperwork. (See Case 3 of Exhibit 22.9). When a report is needed, it can be entered directly into the computer.

Hundreds of forms used in a RCMP detachment (see paragraphs 22.59).

22.66 The RCMP has also introduced its version of a paperless system. However, its approach focusses on reducing the number of paper files rather than on eliminating the reporting requirements for minor cases. This system continues to require RCMP members to handwrite reports for all cases. These reports are then entered into the Police Information Retrieval System. Subsequently, the paper reports are destroyed, to reduce the floor space needed to store them. However, although the number of paper files the RCMP keeps has been reduced, the number of reports members must write has not changed significantly. This is because the reporting requirements for minor cases (approximately 60 percent of the total) were not addressed first.

22.67 In 1990, RCMP headquarters began another initiative to streamline case–reporting practices. The objective was to extend the RCMP's computer technology to create a paperless reporting environment that would relieve members of tedious, time–consuming tasks so that they would have more time for policing duties. However, the progress on this action plan has been slow due to competing priorities, which have diverted resources away from this area.

22.68 We believe that to effectively reduce paper burden it is best to involve front–line officers. In our visits to RCMP detachments during the audit, we found many innovative local solutions that could be beneficial to the rest of the Force. The headquarters "streamlining" initiative needs greater and more co–ordinated inputs from operational personnel through, perhaps, the Aboriginal and Community Policing Directorate.

22.69 In carrying out the project to reduce paper burden, the RCMP should involve its operational managers and consider:

- **reducing reporting requirements for minor cases;**
- **adopting proven local improvements wherever feasible; and**
- **as the "operating budget" concept is implemented, establishing the optimum mix of uniformed members and civilian support staff in its provincial detachments.**

RCMP response: *Agree. The specific suggestions made by the Auditor General will be carefully considered.*

Performance Measurement

22.70 Although measuring police performance is a difficult task, a consensus has developed in recent years on how it can best be done. Many police managers believe that by tracking key indicators over time and using these indicators to compare their own police departments with others, they can measure the performance of their organizations in a meaningful way. Indicators that are often used include crime statistics and trends, response time, clearance rate, caseload per officer and population per officer.

22.71 The RCMP has two principal management information systems — the Operational Statistics Reporting (OSR) system and a person–hour reporting system known as the C75D system. We estimate that they cost the RCMP at least $20 million per year to maintain. This includes the time spent on completing data collection forms and reviewing them, entering data into the computer, processing the data and producing summary reports.

The RCMP needs to improve its performance measurement related to contract policing

It is essential to measure police performance.

22.72 We reported in 1981 that the RCMP's performance indicators had generally not been accepted by managers, or used for management purposes. In our current audit, we found similar problems. The RCMP uses the two systems to produce various summary reports for internal and external presentation. However, it does not make systematic and consistent use of indicators such as clearance rates and caseload per officer to measure the performance of its contract policing units. The RCMP has developed a national resource allocation model, incorporating a set of workload indicators based on hours per case for various types of crime. However, only certain divisions have accepted this model. Others have developed their own models using different workload indicators. These indicators, both national and divisional, have been used mainly in planning and rarely for managing ongoing operations.

22.73 In our opinion, the inconsistent, ad hoc approaches to measuring performance are the result of several factors. First, although the RCMP has identified a new set of results and performance indicators in its 1990 Operational Planning Framework, it has not clearly defined where all the data sources are, when reports are to be produced, what standards are to be used to judge a unit's performance and how managers at various levels will be held

Exhibit 22.10

Forms and Reports Required for an Impaired Driving Case

Form or Report	Whose Requirement
1. General Occurrence Report	RCMP
2. Continuation Report	RCMP
3. Breathalyzer Operational Checksheet	RCMP
4. Certificate of a Qualified Technician	Legal
5. Information (to commence prosecution)	Legal
6. Promise to Appear	Legal
7. Fingerprint Identification	Legal
8. Prosecutor's Information Sheet	Crown Prosecutor
9. Crown Brief (not needed if pleading guilty)	Crown Prosecutor

In addition to the above compulsory forms, other documents are often required depending on the circumstances of the arrest:

10. Prisoner Report	RCMP
11. Motor Vehicle Accident Report	Ministry of Transport
12. Witness Statement	RCMP
13. Motor Vehicle Inventory	RCMP
14. File Conclusion Report	RCMP
15. Public Complaint	RCMP Public Complaint Commission

to account for their performance in the context of contract policing.

22.74 Second, both the OSR and C75D systems were developed some years ago, and they have not been able to meet the needs of today's management. For example, because they were designed as two separate systems, there has been a continuing need to integrate them to produce the necessary performance information on a more timely and regular basis. However, the RCMP's efforts to integrate the systems over the past few years have not been successful. With the emergence of community–based policing, there is also a need to develop new information systems to collect data on the related performance indicators.

22.75 Furthermore, a recent RCMP internal audit report indicated that there was a significant lack of training, knowledge and appreciation of the capability of the OSR and C75D systems among those who should be making maximum use of performance information. In our opinion, this problem can be eliminated only if the RCMP develops a clearly articulated performance measurement system.

22.76 In 1991, the RCMP assigned to its Corporate Management Sector the responsibility for developing standards for management information systems in the Force. We believe this is an important move toward improving performance measurement practices and management information systems in the RCMP.

22.77 The RCMP should improve its performance measurement practices and management information systems related to contract policing — its largest program.

RCMP response: *Agree. These two initiatives are already under way.*

The Review and Audit Function

22.78 In carrying out its policing services, the RCMP must comply with the law and must maintain the highest standards of objectivity, fairness, justice and integrity. It must also be methodical and meticulous, because cases may be lost on technicalities. There are numerous RCMP regulations, policies and procedures to help ensure that these standards are met. There is also an extensive system of front–line supervision, reviews and audits to ensure compliance with these regulations, policies and procedures. We estimate that the direct cost of this system exceeds $50 million per year.

The RCMP needs to establish a balance between its focus on compliance and on performance

22.79 In recent years, quality and managerial reviews have repeatedly flagged recurring deficiencies such as non–compliance with policy in handling case exhibits, poor note–taking and errors in the data input to the management information systems. As a result, internal auditors have had to spend a significant amount of their time dealing with compliance issues and have not been able to assess the economy, efficiency and effectiveness of individual RCMP units.

22.80 In addition, the RCMP's cyclical approach to review requires periodic reviews (for example, annual quality review and biennial managerial review) of every detachment, even those that previous reviews and audits have found to be generally well managed. Reviews in such cases are neither economical nor efficient because they use resources that could be directed toward higher–risk areas.

22.81 The RCMP is aware of these weaknesses and has been addressing them.

Community–based Policing — A New Focus

22.82 The RCMP started to move toward community–based policing in the mid–1980s. In 1990, it launched a number of strategic action plans aimed at taking itself into the twenty–first century. These plans include implementing the community–based policing concept. The RCMP has told the provinces of its commitment to community–based policing and informed Parliament, through its annual expenditure plans, that it has made progress. This progress includes:

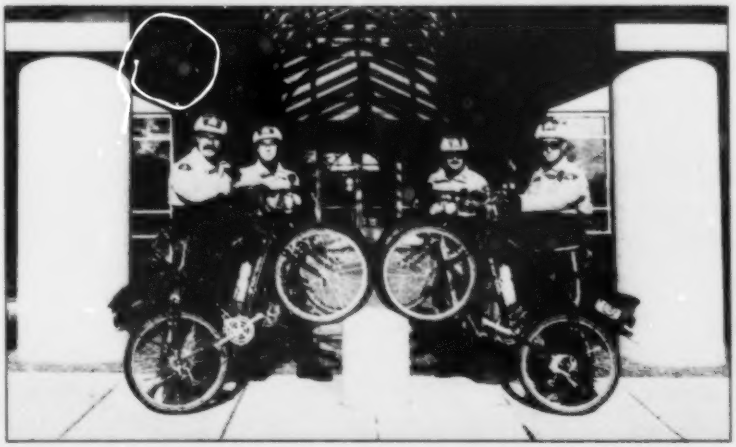
- increasing the hiring of women and visible minorities;
- emphasizing cross–cultural training at the academy;
- establishing positions responsible for aboriginal policing in each division in 1991;
- creating a new directorate responsible for community–based policing and amalgamating it with the aboriginal policing directorate in 1991;
- issuing a directive on community consultative groups in 1991;
- installing the mission statement in each community in May 1992; and
- experimenting with innovative approaches in certain detachments and sub–divisions, starting in 1992.

There has been some progress and some delay

22.83 We reviewed the action plan to implement community–based policing throughout the Force. We found that it included essential projects such as developing a statement of principles, publishing a handbook, developing training programs and identifying changes needed in related personnel policies to meet community–based policing requirements.

22.84 However, some key projects have encountered delays. For example, the handbook on community–based policing, which was scheduled for distribution in March 1991, was not started until recently when a survey to determine the level of understanding was completed. The handbook is intended to guide RCMP commanders in implementing the community–based policing in their detachments. As planned, the handbook would contain guidelines and criteria for developing differential response strategies and various other problem–solving techniques. The absence of the handbook on community–based policing means that RCMP members may not have the guidance needed to develop a consistent understanding of the concept.

22.85 There were reasons for the delays. First, the two key positions in the community policing directorate were not filled until late 1991. Second, the project organization has generally been underfunded and understaffed since the beginning. Furthermore, as the directorate was newly created, it had to establish mechanisms for consultation with field personnel and co–ordination with other action plans.



Bicycle patrol — an innovation under the community–based policing concept — RCMP Surrey Detachment (see paragraphs 22.82).

22.86 Community–based policing will be a total reorientation in service delivery that entails reorganization and re–education throughout the RCMP. As a result, changes will be difficult and time–consuming given the size and geographical distribution of the Force.

22.87 The RCMP will have to re–examine its policies and practices in areas such as recruit selection and training, in–service training, performance evaluation, pay levels, organizational structure, career streaming, job rotation and posting of members to their home provinces. Details of these issues are discussed in Chapter 23, on Human Resource Management.

22.88 The RCMP should review its progress in implementing the community–based policing concept and ensure that all related action plans are properly co–ordinated and monitored.

RCMP response: *Agree, although the fact that community–based policing entails complex organizational changes means that unforeseeable difficulties may prolong the implementation period.*

Cost Sharing — How Much Does It Cost the Federal Government?

22.89 Ever since the federal government entered into contract policing, it has been charging provinces and municipalities for RCMP services. The basis for determining what the federal government charges has changed over the years, but one fact has remained constant: the federal government has never attempted to recover the full cost of providing these services because it believes there are a number of benefits that have accrued to the federal government from the arrangement (see paragraph 22.10).

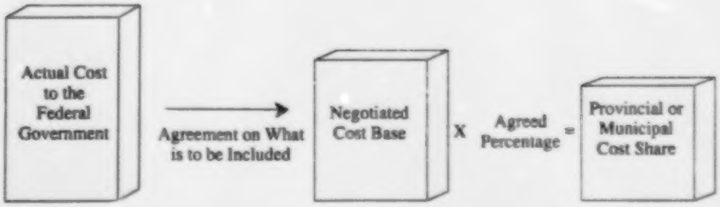
22.90 The federal government and the provinces have agreed to a two–stage process for determining how costs will be shared. First, they negotiate what is referred to as a "cost base". The two parties determine which items will be included in this negotiated cost base and which will be excluded. Second, they agree on the percentages of the negotiated cost base that provinces and municipalities each will pay. Therefore, when the provinces and municipalities agree to cover, respectively, 70 and 90 percent of the negotiated cost base, in reality they are paying less than 70 and 90 percent of the actual total cost (see Exhibit 22.11).

22.91 In September 1989, based on the negotiating parameters approved by the Treasury Board, the federal government made an initial offer to the provinces to begin negotiating a new agreement that would replace the old contract, due to expire on 31 March 1991. In negotiating a new agreement, the Government of Canada stated that it wanted "to achieve a more appropriate apportionment of the costs" and to have the negotiated cost base adjusted "to ensure that it more fully reflects the costs of delivering the RCMP policing service".

22.92 To achieve these objectives, we believe that the negotiating parties must thoroughly understand how much it actually costs the federal government to provide police services through the RCMP. We also believe that disclosure of the actual costs would enable the governments and Parliament to assess more accurately the costs and benefits of contract policing.

Exhibit 22.11

The Concept of the Negotiated Cost Base


Actual Cost to the Federal Government
Agreement on What is to be Included
Negotiated Cost Base
X
Agreed Percentage
=
Provincial or Municipal Cost Share

22.93 We reviewed documents prepared by the RCMP for officials of the federal and provincial governments involved in negotiating the new agreement. We noted that the RCMP had conducted several studies including analyses of the costs of accommodation and recruit training. In its offer of September 1989 the federal government proposed not only to adjust and add items to the negotiated cost base, but also to increase the rates of recovery for provincial and municipal policing to 75 and 95 percent respectively.

22.94 The provinces rejected these proposals, the negotiations became protracted and the 1981–91 contract was extended by another year. Negotiations continued, and the federal government finally signed a new 20–year agreement with the provinces in April 1992.

The 1992 cost base is an improvement

22.95 We compared the cost base in the 1981–91 agreement with that in the new 20–year agreement of 1992. In our opinion, the new negotiated cost base is an improvement as it more accurately reflects actual costs. Although the rates of recovery remain unchanged, the 1992 agreement adds several new items to the old negotiated cost base, such as the employer's share of Unemployment Insurance premiums, and a share of the expenditures of the RCMP Public Complaints Commission and the RCMP External Review Committee. It also increases charges for accommodation and recruit training. However, despite these improvements, the new negotiated cost base still does not fully reflect actual costs.

22.96 To determine the gap between the negotiated cost base and actual costs, we conducted a study using the 1990–91 cost data obtained from the RCMP and applying the guidelines outlined in the Treasury Board's Guide to the Costing of Outputs. We estimate that the new negotiated cost base is $800 million, or an increase of about $50 million over the previous cost base. However, we also estimate that the actual cost to the federal government of providing contract policing services ranged between $900 million and $950 million. Thus, there is a gap of between $100 million and $150 million.

There are other items to be considered

22.97 Some major cost items, such as departmental administration, EDP services and certain employee benefits paid by the federal government, are still excluded from the new negotiated cost base. Other items such as accommodation charges, although included in the cost base, have not been set at reasonable levels (see Exhibit 22.12).

Exhibit 22.12

Costs that Are Excluded or Are Incorrectly Included In The Negotiated Cost Base

I. ITEMS EXCLUDED

1. Departmental Administration

The RCMP's departmental administration activity costs about $60 million per year. It includes personnel, finance, materiel and facilities management, corporate services and other headquarters functions. These functions support all operational units: federal enforcement, protective services, and contract policing.

Thus it is reasonable to assume that a portion of the cost of this $60 million activity should be recognized as part of the actual cost of contract policing. Using a standard cost allocation method, we estimate that about $31 million should be allocated to the contract policing cost base for departmental administration.

2. Others

- Informatics and EDP services
- Certain employee benefits paid by federal government on behalf of the RCMP
- Physical and electronic surveillance
- Ex gratia payments
- Professional services
- Building security
- Work performed by federal personnel

II. ITEMS INCORRECTLY INCLUDED

1. Accommodation Charges

In the 1981–91 agreement, the RCMP charged the provinces a flat rate of $5 per square foot for accommodation in all Crown–owned properties used in provincial policing. An RCMP position paper indicated that the $5 per square foot was unrealistically low. Accordingly, the 1992 agreement raises this rate to $10 per square foot on a gross space basis instead of the net space basis used under the old contract.

This new rate, although an improvement, is still low because it does not reflect the total of land acquisition, construction and interest costs. We also found that municipalities typically charge more than $10 per square foot when renting accommodation to the RCMP.

If, for example, the rate were to be raised to $15 per square foot, the cost base would be increased by $12 million annually. The RCMP needs to determine more precisely what the rate should be before the five–year review.

2. Others

- Recruit training

22.98 The 1992 agreement provides that, on every fifth anniversary of the agreement, the cost base may be reviewed and, if mutually agreed, adjusted to reflect reasonable federal expenses. This review provides an opportunity for the federal government to discuss further adjustments with the provinces. To take advantage of this opportunity, the federal government needs to study the current negotiated cost base and determine the full and actual costs of providing contract police services.

22.99 The Ministry of the Solicitor General, in consultation with the Treasury Board Secretariat, the Office of the Comptroller General and the RCMP, should determine the full and actual costs it incurs in providing contract police services and compare these to the current negotiated cost base.

Ministry's response: *The federal government recognizes that certain elements of RCMP contract policing costs were not included in the 1992 negotiated cost base and that current accommodation charges may not, at all locations, reflect 100 percent of actual costs. However, the government acknowledges the need to determine and allocate full costs through the mechanism provided by the five–year review of the cost base.*

TBS and OCG response: *The Treasury Board Secretariat and the Solicitor General Secretariat have already agreed to a study to determine the full cost of RCMP contract policing in preparation for the first five–year review.*

RCMP response: *Agree. The RCMP will participate with the Treasury Board and the Solicitor General Secretariat in this endeavour.*

22.100 The federai government should provide the above information to officers of both federal and provincial governments who will be involved in the five–year review of the cost base.

Ministry's response: *Full cost information on contract police services will be provided to both federal and provincial officials involved in the five–year review.*

TBS and OCG response: *The methodology for the cost study will be established in 1992–93 by the Solicitor General Secretariat and the study will be scheduled for completion no less than 18 months in advance of the first five–year review. The results of the study should be made available to provinces prior to review of the cost base.*

RCMP response: *Agree. The RCMP will participate with its federal partners in this endeavour.*

Mechanisms to ensure accurate interpretation and billing on cost sharing are inadequate

22.101 The Ministry of the Solicitor General represents the federal government in contract negotiations. However, once the federal Solicitor General and his or her provincial counterparts sign the contract, the RCMP is responsible for accounting and billing functions related to cost recovery.

22.102 We found that the RCMP has been allowed to interpret the terms of cost sharing and to change the methods used to calculate the cost of certain items without consulting the Ministry of the Solicitor General. During the term of the 1981–91 agreement, the RCMP made several interpretations in favour of the provinces. One such decision involved excluding the salaries of police recruits when calculating the cost of recruit training. As a result, between 1985 and 1992 the revenues of the federal government were about $35 million less than could otherwise have been the case.

22.103 We believe that, since the Solicitor General signs the contract on behalf of the federal government, there is a need for Ministry officials to be responsible for ensuring that the RCMP complies with the terms and conditions on cost sharing when carrying out the accounting and billing operations.

22.104 The Ministry of the Solicitor General should establish mechanisms to ensure that interpretation and billing on cost sharing will be subjected to adequate review.

Ministry's response: *The Ministry of the Solicitor General will investigate the establishment of an independent review mechanism to oversee the interpretation and billing of federal, provincial and municipal shares for contract police services.*

Federal government documents do not provide adequate information to Parliament on the costs of contract policing

22.105 Contract policing is the largest RCMP program, costing more than $900 million each year. It is also one of the federal government's largest cost–recovery programs, with an annual revenue of about $600 million. Therefore, it is very important to provide adequate information for Parliament, showing the actual cost of contract policing and the amounts that the federal government recovers. Without such information, it is not possible for Parliament to exercise effective scrutiny of RCMP expenditures.

22.106 We reviewed the RCMP's expenditure plan (Part III of the Estimates) for 1992–93, and we have some concerns. For example, the plan does not indicate that the provinces and municipalities are sharing only items in a negotiated cost base that, as noted earlier, reflects only part of the actual cost to the federal government of providing contract policing services. From the information presented in the plan, readers can see the amount of money the federal government recovers from the provinces and municipalities, but cannot determine the actual cost of contract policing. In fact, the placement of the figures could lead readers to conclude that the federal government is recovering $596 million of an actual cost of $730 million when, in reality, the actual cost is most likely more than $900 million.

22.107 Similarly, the Solicitor General's annual reports show the RCMP's net cost for contract policing as the difference between its expenditures and the amount recovered. In our opinion, these figures do not present an accurate picture.

22.108 The Ministry of the Solicitor General and the RCMP should, in consultation with the Office of the Comptroller General, develop a presentation package for inclusion in the RCMP's expenditure plan and the Solicitor General's annual report that will clearly and accurately present to Parliament the total cost of contract policing and the net cost to the federal government.

Ministry's response: *The Ministry of the Solicitor General will undertake consultations with the Office of the Comptroller General with a view to improving the disclosure of contract policing costs to Parliament.*

RCMP response: *Agree. The RCMP will collaborate with the Solicitor General and the Comptroller General to develop a clearer method of displaying information in the RCMP expenditure plan.*

All parties, including Parliament, need to know the actual costs of RCMP contract policing services.

Chapter 23

Royal Canadian Mounted Police

Human Resource Management

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Royal Canadian Mounted Police

Human Resource Management

Assistant Auditor General: David Rattray
Responsible Auditor: David Brittain

Main Points

23.1 The management of human resources is the single most important factor in determining overall RCMP effectiveness. Knowledgeable, skilled and motivated individuals of high integrity are essential to effectively serving the Canadian public. These resources account for approximately 80 percent of the RCMP's $1.8 billion operating budget.

23.2 The RCMP operates in an evolving environment that increasingly demands re-examination of the way it conducts its operations and provides its services. The Force has recognized the need for change and has undertaken a series of major initiatives. A critical component of these initiatives has been the fundamental renewal of its human resource management systems and practices. Projects are under way in such key areas as recruitment, training, career management and member health.

23.3 During our audit we identified a number of areas for improvement: human resource planning, recruit selection, recruit training, refresher training and member career management. As stated above, the RCMP was in the process of addressing many of these areas. Given these initiatives and the importance of their success, we will be monitoring the Force's progress in these areas.

Introduction

The RCMP is a large diverse organization

23.4 The RCMP is Canada's largest police force with a total workforce of about 21,000 employees. Some 16,000 uniformed members and 5,000 civilian members and public servants perform a wide variety of law enforcement functions across Canada. Its responsibilities can be grouped into five broad areas:

- **municipal and provincial police services** in 8 provinces, 2 territories and 191 municipalities;
- the **enforcement of federal statutes** across Canada in such areas as drugs and commercial crime;
- **protective services** in airports and for Canadian and foreign diplomats;
- **specialized services** for the Canadian law enforcement community in such areas as criminal records, forensic laboratories, fingerprint identification and police training; and
- **corporate management** and **administration**.

23.5 Approximately 80 percent of the RCMP's $1.8 billion budget is related to human resources. These resources are geographically dispersed across Canada, with a national headquarters and 13 operational divisions — one in each province and territory and one in the National Capital Region. The management of those human resources is the single most important factor in determining overall RCMP effectiveness.

The Human Resource Management Challenge

23.6 Millions of Canadians judge the RCMP by the qualities and conduct of its uniformed members. Knowledgeable, skilled and motivated people of high integrity are essential to effectively serving the Canadian public. For that reason, the way the RCMP selects, trains, deploys, supervises and evaluates its uniformed members is critical to its overall success.

The RCMP's human resources are its most vital asset.

23.7 The Commissioner recognized that the people in the ranks are of critical importance to the Force when he said, "Human resources have always been, and continue to be, the most vital asset of organizations. This is certainly true of the RCMP, which exists only by virtue of the many men and women who deliver the services for which the organization is famous."

23.8 RCMP officers have served Canada well in the past and continue to do so today. However, the Force faces a wide range of human resource challenges and pressures that will affect the overall performance of its duties. Budget restraint, rising public expectations, human rights legislation, increased public scrutiny and changes in the composition and culture of those they serve directly affect all public sector organizations across Canada.

23.9 Some of the pressures the RCMP faces flow from its unique national role. The Force has traditionally placed great value on hierarchy and centralized control. This orientation reflects its central role in Canadian history as a nation–building institution, as well as a need and desire to maintain a national approach to a national police force. At the same time, geographic dispersal, varying roles in different parts of the country and other factors have placed a premium on recognizing local needs. Creating the right balance between meeting regional needs and maintaining national standards and policies has always been an important and delicate task.

23.10 This balance is likely to become more difficult to maintain in the future as Canadian society becomes increasingly diverse. Moreover, the role and make–up of the Force are evolving and diversifying as well.

Community-based policing — which involves integrating the police officer into the community to a greater extent and emphasizing crime prevention — is an RCMP priority. So too is the need to create a police force that represents Canadian society in race, gender, and language.

23.11 The RCMP also faces a number of other internal challenges. Its workforce is aging, which has implications for areas such as officer health and turnover. A number of uniformed members' careers are plateauing because of fiscal restraint resulting in fewer promotional opportunities. Restraint and increased demands on policing require that the Force consider further the use of civilians in some uniformed officer positions. Finally, the increased emphasis on employee rights has had an impact on discipline, discharges and grievances.

23.12 Yet another factor that affects human resource management is the Force's long-standing philosophy of moving its personnel to meet its operational needs and develop its members. This institutionalized mobility poses a challenge for the RCMP and the individual police officer alike. The RCMP faces the formidable and expensive task of moving thousands of officers annually, while police officers must quickly adapt to new environments and responsibilities.

23.13 Historically, the RCMP has preferred to hire its uniformed members at the recruit level and develop them within the organization. Virtually everyone — from constable to Commissioner — starts at the bottom and works through the system, beginning with general policing and then sometimes specializing in a wide variety of RCMP activities depending on their aptitudes and interests. Such practices reinforce the critical nature of effective recruit selection and training, and of filling jobs with the right incumbents.

23.14 In response to these internal and external challenges, the RCMP has embarked on the renewal of human resource management. In May 1991 it introduced a Human Resource Strategic Action Plan with the objective of implementing, by 1993, a creative and effective human resource management system that will be responsive to the needs of the RCMP. As a result, a number of specific objectives were defined and tasks were initiated. These are outlined in Exhibit 23.1.

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Some 16,000 uniformed members perform a wide variety of law enforcement functions across Canada (see paragraph 23.4).

Audit Objective and Scope

23.15 The objective of the audit was to determine whether the RCMP's management systems and practices with respect to its uniformed members:

- enable it to maintain a workforce that can meet its mandate and priorities; and
- reflect due regard to economy, efficiency and effectiveness.

We did not audit human resource management as it relates to civilian members and public servants employed by the RCMP.

23.16 Given the challenges now facing the RCMP, we focussed on several key aspects of human resource management that relate to police officer performance. These included recruit selection, recruit training, post–recruit training, career management and member health. We examined each area in terms of generally accepted "best" practices within police and other organizations, and due regard to economy, efficiency and effectiveness.

23.17 Because the Force had major human resource management initiatives under way, it was essential that the audit take into account their probable impact and any weaknesses identified.

Human Resource Planning

23.18 Effective human resource management occurs only through a systematic, planned approach to dealing with people management problems rather than through ad hoc responses to such problems. An ability to visualize the future and develop strategies to meet that vision and the will to see plans to completion are essential. Given the scope and complexity of the challenges facing the RCMP in human resource management, it is critical that its strategies be relevant, co–ordinated, realistic and well managed.

The Human Resource Management Strategic Action Plan

23.19 As mentioned earlier, the RCMP is re–examining several major aspects of its human resource management. It has recognized the need for comprehensive, responsive and forward–looking strategic planning. In May 1991 the Force initiated its first Human Resource Management (HRM) Strategic Action Plan, to systematically support the Commissioner's Force–wide long–term strategy, first put forward in 1989.

23.20 By May 1992, the Force had issued an updated HRM Strategic Action Plan. This update addressed a number of the concerns we had with the earlier approved version. It shows:

- more progress toward the completion of several projects;
- enhanced description of project content and adjusted project completion dates;

Major human resource management initiatives are under way in the Force.

Exhibit 23.1

Objectives and Tasks Initiated

Objective 1: Improved Human Resource Management Systems and Structures
  A. Human Resource Information Management Systems
  B. Delegation of Authority
  C. Public Service Personnel Regional Organization
  D. Training Directorate Organization
  E. Integration of Planning Process
  F. Public Service 2000

Objective 2: Human Resource Management Policies
  A. Recruitment Policies and Entry Requirements
  B. Transfer Policy
  C. Career Streaming
  D. Promotional Practices
  E. Civilianization – Categories of Employees
  F. Target Group Participation
  G. Aging Population

Objective 3: Training and Development
  A. Training and Development Programs
  B. International Training

Objective 4: Performance Standards
  A. Productivity Standards and Measures
  B. Appraisal Systems

Objective 5: Grievances
  A. Improvements in the Current Process

- a high priority placed on the completion of the Task Analysis project (see paragraphs 23.21 – 23.22); and
- more linkage and integration of projects.

The human resource management information system needs to be improved.

23.21 Critical to the overall success of many of the components of the Strategic Action Plan is the completion of a major task analysis project. Task analysis defines and verifies the tasks, skills and other qualifications required to perform job duties. It is widely recognized as the foundation of several key areas of personnel practice. The lack of verifiable information on job requirements compromises the effectiveness of recruitment and training. Without a clear definition of what an employee is expected to know and do in his or her job, it is also difficult to evaluate on–the–job performance and to promote or rotate employees based on their suitability for particular jobs.

23.22 As early as 1975, the RCMP had examined the feasibility of conducting a task analysis of its jobs. It was not until 1987 that the concept of such an initiative was accepted. Subsequently, Task Analysis became a project within the Human Resource Management Strategic Action Plan. Completion of this project is considered essential to the success of several other strategic initiatives within the Plan.

23.23 The revised Human Resource Strategic Action Plan has now been communicated to all members across the Force. In addition, project monitoring has been enhanced.

23.24 Since the RCMP is addressing many of the deficiencies identified earlier in its Strategic Action Plan, we will review the implementation and impact of the Plan during our follow–up.

RCMP response: *Agree.*

Management Information

23.25 In any organization, information is the raw material for not only planning but all decisions and activities. It is integral to an organization's ability to assess performance, meet goals and adjust its behaviour. Organizations need to collect and analyze data in a form that management can use.

23.26 Currently, RCMP human resource information systems have some significant inadequacies. For example, the PARADE system, which provides much of the basic human resource data required, does not meet the needs of the Force. System technology is out-of-date and it is difficult to get information out of PARADE. In addition, there is a need to co–ordinate PARADE data analysis. For example, those analyzing PARADE data have provided different answers to the same management information questions.

23.27 Our review of RCMP human resource information and analysis requirements in several areas indicated a need for improvement. In some areas, key data did not exist. In others, information and analysis were inadequate. The following are some examples.

- More data and analysis in such areas as recruit hiring and recruit attrition are needed to better assess the effectiveness of recruitment practices.
- There is insufficient information on file to support promotion decisions and overall human resource planning.
- Although management controls exist for relocation of members where a financial cost is incurred, there is insufficient information and analysis on the extent of and reasons for other member position changes.
- The collection of health information needs to be automated in such

areas as use of sick leave, injuries to members and health program performance.

23.28 Manuals, guidelines and directives are another source of management information. In such areas as recruitment and promotion, these essential tools were often either non-existent or unclear. Therefore, divisions (and sometimes individuals) have had to develop their own, which has led to inconsistent application of policies and practices.

23.29 As part of its current Strategic Action Plan, the RCMP has undertaken a project to improve its human resource information. Its goal is twofold:

- to develop a new unit in Personnel to control human resource information; and
- to review and update or replace the current PARADE system.

23.30 Given that the RCMP is currently addressing concerns about information for human resource management, we will review progress in the availability of such information and in the level of human resource data analysis during our follow–up.

RCMP response: Agree.

Civilianization

23.31 Another major RCMP human resource planning initiative under way is the "civilianization" project. Among other things, this entails determining the extent to which uniformed member positions can reasonably be filled by civilians at both national and divisional headquarters.

23.32 Historically, police forces have filled a minimum number of positions with civilians for the following reasons:

- They want to keep positions open for uniformed members who are temporarily or permanently unable to carry out the full range of operational policing duties.
- These positions provide an avenue for career development for uniformed members aspiring to management positions.
- Uniformed members in these positions are available for policing duty in an emergency.
- They perceive that uniformed officers will do a better job because they understand operational policing.

23.33 The Force has always had civilians; they are most prevalent in clerical and administrative support positions. The Force has also used civilians in many line positions in areas such as forensic laboratories, identification and dispatchers in communication centres. Recently, the Force has appointed a civilian as head of forensic laboratories.

23.34 Our survey of police departments in Canada indicates that approximately one quarter of their workforces have been civilianized. Like the RCMP, most of their civilian positions are in administrative and operational support. However, there is a current trend among police departments to use civilians in several other areas: administration and technical management; finance and personnel; and additional operational support areas such as records management, crime statistics analysis, information systems as well as court and victim services. The main reasons for this trend are lower personnel costs, the availability of trained, job–ready employees in the civilian population and the need for new skills.

23.35 There would appear to be potential, therefore, for the RCMP to further use civilians in uniformed member positions in such areas as Finance, Services and Supply, and Staffing and Personnel. This is something the RCMP has been examining.

23.36 In 1988 the RCMP conducted an internal study of the use of uniformed members in non–police functions (see Exhibit 23.2). This study focussed on 1,303 positions mainly at national and divisional headquarters.

23.37 The study team initially determined that almost 500 positions did not require police–related qualifications. Of these, RCMP management reduced to 64 the number of positions recommended for civilianization. The study also concluded that staffing a sample of 281 positions with civilians would save the RCMP $2.3 million, or 16.7 percent of the cost of these positions. In addition, the RCMP is currently re–assessing the criteria for establishing categories of employees used in this study. In our opinion, given the trends in other police forces and the possible benefits of civilianizing, the RCMP needs to reassess this area.

23.38 Given that the RCMP is currently studying the potential for further civilianization, we will review this area as part of our follow–up.

RCMP response: Agree.

Exhibit 23.2

RCMP Civilianization Process

(January 1988 – April 1991)

Positions/Activities Reviewed for Potential Conversion		Recommended Positions/ Activities for Conversion		Approved Positions/ Activities for Conversion through Attrition	
1303 positions		497 positions		64 positions	
Administration	66				
Finance	120	Finance	120	Finance	12
Services and Supply	75	Services and Supply	75	Services and Supply	10
Staffing and Personnel	157	Staffing and Personnel	61	Staffing and Personnel	10
Training	237	Training	20	Training	7
Informatics	260	Informatics	137	Informatics	11
Identification	62	Identification	23	Health Services	1
Forensic Labs	14	Forensic Labs	10	Corporate	3
Other	312	Other	51	Information Access	5
				Protective	5

Recruit Selection

The screening process for recruits is key to the success of the RCMP

23.39 Selecting the most qualified and capable people to serve as police officers is a crucial first step to effective policing. Effective recruit screening means choosing people at the outset who have the "right" personality and aptitudes for police work, and screening out the others. However, as indicated in paragraphs 23.21 and 23.22, the Force is in the process of determining the skills, knowledge, aptitudes and other qualities associated with particular jobs. This information is especially critical to recruit people who can fill a variety of positions among the more than 1,000 jobs that RCMP members may be called on to do.

23.40 Substantial salary and other costs can result from hiring and training unsuitable recruits who may leave the Force during the training or probationary period. As well, hiring people who are unsuitable as police officers leads to inferior police work, public complaints and incidents that could damage the Force's image. A rigorous, effective process for screening recruits can play a large part in avoiding these financial and non-financial costs.

23.41 The RCMP selection process consists of nine steps (summarized in Exhibit 23.3). Of these, the selection test and interview are perhaps the most important in screening out unsuitable applicants. Our audit found deficiencies in these key elements. The RCMP is re–examining many aspects of recruit selection, including many of our concerns.

The Recruit Selection Test could be improved

23.42 The current Recruit Selection Test introduced in 1991 was intended to correct weaknesses (such as gender bias) in the earlier test. It is designed to measure several abilities and characteristics: observation, perseverance, computation (arithmetic), basic composition, logic, memory, and judgment. Although this new test is an improvement over the previous one, we found certain weaknesses:

- It does not measure some of the skills or attributes it is designed to measure (memory, observation and perseverance).
- Candidates can easily guess the answers to certain questions.
- There are indications that the test has some linguistic bias.

The process for interviewing potential recruits needs to be improved

23.43 The other key step (in addition to the test) in screening recruits is a single interview by one individual. Our survey of other major police forces indicated that the screening process normally involves multiple interviews by a team of interviewers, and a final review by a selection committee.

23.44 RCMP interviewers have guidelines and a scoring system for structuring and standardizing interviews. However, the process is often subjective and inconsistent. For example, some interviewers do not use the guide. Those who do often use it differently. Some recruiters have developed their own guides and questions. Yet another problem is the way the recruiters rank applicants. Some use the scoring system, while others rank applicants according to how long they have been on the waiting list. Other police forces not only use a more structured interview process but also have introduced multiple tests (job-specific knowledge and personality tests and psychological assessments), some of which are administered through assessment centres.

23.45 The RCMP knows that it has problems in the interview process and is addressing them.

A weak selection process has real consequences

23.46 We found that weaknesses in the RCMP's selection process can be costly. For example, we estimate that training and salary costs were almost $2 million for members who left the Force during 1989 and 1990 for reasons such as poor interpersonal skills, immaturity, lack of assertiveness and low learning ability. More effective screening could have identified many of these members during recruitment and resulted in lower costs to the Force. Further, supervisors also complain about recruit shortcomings (for example, in personality, attitude, assertiveness and plain common sense) that could have been detected with more effective recruit selection. A recent study conducted by the Canadian Police College has indicated that effective screening, which could identify unsuitable candidates at the outset, can translate into substantial savings.

23.47 The RCMP should improve its recruit selection process by:

- **redesigning the Recruit Selection Test to improve its ability to select the best candidates for the job; and**
- **using a more structured interview process consisting of varied and rigorous screening methods and conducted by qualified interviewers.**

RCMP response: Agree.

Recruitment data analysis is limited

23.48 The RCMP collects certain information on its members, both during the recruiting process and throughout their tenure. However, the Force does not routinely analyze the data to draw a link between its recruiting and screening practices and the success (or lack of it) of particular members. For example, the RCMP does minimal interviewing of members who resign, to find out why they have chosen to do so. Because it does not collect and

Selecting suitable recruits is critical to effective policing.

Exhibit 23.3

Recruit Selection Process

- Initial contact.
- Medical examination and Physical Ability Requirement Evaluation (PARE).
- Completion of application form.
- Recruit Selection Test.
- Candidate interview.
- Security investigation.
- Final medical and Physical Ability Requirement Evaluation (PARE).

Selecting the most qualified and capable people to serve as police officers is a crucial first step to effective policing (see paragraph 23.39).

analyze this type of information, the RCMP cannot measure the effectiveness of the recruiting process by the long–term, on–the–job performance of its members. We noted that the Force does "track" the success of members who belong to minority groups such as women, natives and others. However, more needs to be done to develop similar information on other recruits who have been through the screening process.

23.49 The RCMP should compile and analyze appropriate data to determine the effectiveness of its recruiting and screening processes.

RCMP response: Agree. Recruitment data will be gathered during the development of the new human resource management information system.

Training

Training Program Management

Police training is a critical activity.

23.50 As can be seen from Exhibit 23.4, the RCMP internal training program consists of a host of courses designed to meet the needs of many different jobs. Our rough estimate of expenditures for training is $70 million to $100 million annually.

23.51 Given the range and complexity of the RCMP training program, we focussed on the process for monitoring and controlling courses. We looked specifically at training for recruits such as basic, field and language training as well as post–recruit training courses, including orientation and refresher training offered to all officers.

Exhibit 23.4

The RCMP Has a Wide Range of Training Programs

Basic Recruit Training	Refresher/ Requalification	Specialized Training	Management/ Other
• Regina Academy – Academics – Basic Skills e.g. Swimming Driving • Recruit Field Training – Court – Statutes – Arrest – Admin.	• Language • Orientation • Firearms • Self–Defense – Verbal – Physical • CPR	• Identification • Computers • Technical Skills • Highway/Traffic • Investigation • Immigration	• Inspector Orientation • Police Supervisors • Audit • PSC Courses • Police Administration

Control over standards for training programs is important

23.52 Training in the RCMP is a costly and critical activity. Therefore, it must meet standards to ensure that courses are relevant and current, and that they are properly delivered in a consistent way. The RCMP uses course training standards to centrally control the design, delivery and evaluation of courses. It also ensures that course updates are properly approved.

23.53 During our audit, we noted there was a backlog of course updates awaiting approval in national headquarters. We also found that the RCMP was behind in course validations, which assist in establishing the currency and usefulness of training content.

23.54 The volume of course training standard updates and course validations that must be handled by RCMP headquarters has contributed to these deficiencies. The RCMP is taking steps to improve its approach to course training standard development, program design and course and program evaluation.

23.55 Since the RCMP is in the process of addressing these areas, we will review its progress during our follow–up.

RCMP response: Agree.

Basic Recruit Training and Recruit Field Training Programs

Effective basic recruit training and recruit field training are essential to preparing new recruits for active duty

23.56 The RCMP has been training recruits since 1885. Its basic recruit training program provides new recruits with the basic skills and knowledge required to carry out their duties successfully. The course is approximately 26 weeks long and is offered at the RCMP Training Academy in Regina, Saskatchewan. During 1990–91, 778 recruits went through the program.

23.57 The second and equally important step in the development of new recruits is recruit field training, which equips the new recruit with the necessary operational knowledge and skills to function effectively as a police officer. Recruit field training involves posting recruits, after their basic recruit training, to operational units for six months of on–the–job training.

Opportunities exist to enhance the effectiveness of basic recruit training

23.58 Recruits at the Academy take academics (law, human relations, communications training and training in identification operations) and other courses in basic skills such as driving, physical training, firearms training and drill exercises. The average cost for basic recruit training is about $40,000 per recruit.

23.59 The time and money spent on basic recruit training is related primarily to the number of courses taught. In some areas, if recruits were required to have experience and qualifications in certain areas as prerequisites to basic recruit training, it would be possible to enhance the curriculum. Subjects such as first aid, swimming, CPR and computer skills are possible prerequisites to consider. Such training is readily available at educational institutions in communities across the country.

23.60 Other police forces and training academies have established these subjects as prerequisites. Some examples are shown in Exhibit 23.5.

23.61 We estimate that approximately $450,000 could be saved annually by designating first aid, typing and swimming skills as prerequisites to entering basic recruit training. It may be possible to realize more savings by also requiring recruits to have taken basic courses in areas such as psychology, law and sociology, which are available at community colleges and universities. If the RCMP were to follow this route, however, it might want to have some input into the design and content of the courses. Our rough estimate indicated potential annual savings of up to $1 million if completion of these courses were required before admission to the Academy.

The relevance of basic recruit training content is being reviewed

23.62 The basic recruit training program has not been evaluated since 1976, but is currently under fundamental review. In 1976 recruits were questioning the relevance of some of their courses. We found the same issues and concerns being raised today. A major focus of the current review is assessing the extent to which the basic recruit training reflects new policy directions for the Force, such as community–based policing.

Recruit field training is important

23.63 The 1976 evaluation of recruit training indicated that the recruit field training course standard was out–of–date and, as a result, some RCMP units had developed their own training programs. Although a certain degree of flexibility is needed, field training should be standardized. The RCMP intends to evaluate and update its recruit field training program after it

Exhibit 23.5

Prerequisites at Other Training Academies

	First Aid/ CPR	Typing Skills	Swimming
Atlantic Police Academy	X	X	X
Ontario Police College	X		
Justice Institute of British Columbia	X		X

completes a study of its basic recruit training program.

23.64 We believe that the RCMP should assign a high priority to the basic recruit training and recruit field training programs, given their role in developing qualified police officers. Accordingly, we will be following up on the Force's review of these programs to determine whether the review has examined:

- **the benefits of requiring recruits to have certain knowledge and skills before they begin basic recruit training;**
- **the relevance of current basic recruit training courses to contemporary police work in general, and to community-based policing in particular; and**
- **the course training standards for recruit field training to ensure they are up-to-date.**

RCMP response: Agree.

The release of unsuitable recruits is difficult

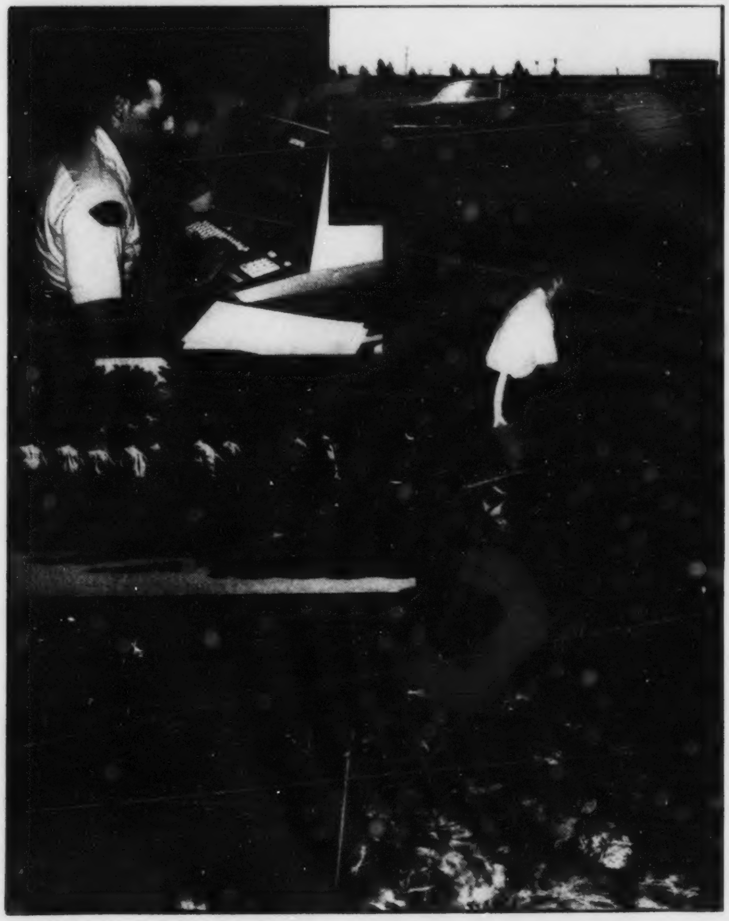
23.65 Police officers are the public face of the force. The day-to-day contact of individual officers with the public is, in reality, what constitutes the successful delivery of police services. Screening out unsuitable candidates at the outset is essential to ensuring that the best people are hired (see paragraph 23.39.) After selection, the release of unsuitable individuals during recruit training and probation is equally important.

23.66 People who might have been screened out under a different selection process are proceeding to basic recruit training and recruit field training. We found that about half of the recruits who had problems in basic recruit training had the same problems later in recruit field training.

23.67 Our audit found that it is difficult for the RCMP to release unsuitable recruits during basic recruit training and recruit field training. Specifically, we noted the following:

- The discharge process is weak; in general, recruits must leave voluntarily, if they leave at all. We noted that, since 1988, only one recruit had been discharged within the two-year probation period.
- Further, our discussions with staff at the Academy and in the field revealed the same problems.

23.68 The RCMP should improve its process for the release of unsuitable recruits.



Recruits at the Academy take academics (law, human relations, etc.) and other courses in basic skills such as driving, physical training, firearms training and drill exercises (see paragraph 23.58).

RCMP response: Agree. The discharge process from the Academy has been addressed.

Official Languages Training for Recruits

Official languages training is a major RCMP focus

23.69 The RCMP has made official languages training a priority. It offers all new recruits the opportunity to participate in official languages training. A six–month program was established in 1988 and is voluntary. The program is designed to equip participants with "B" level language proficiency, as defined by the Public Service Commission. Language training is provided in Montreal before the recruit proceeds to basic recruit training. Our estimate of the cost of the language training program ranges from $5 million to $7 million in 1990–91 (or $30,000 to $40,000 per recruit). Between 1988 and 1991, 453 recruits participated in the six–month program. This number represents 20.7 percent of the 2,082 recruits engaged during that period.

23.70 This year, the RCMP began to evaluate the program, to assess the extent to which recruits retained the second official language and used it during subsequent training. Building on that initiative, and working with the RCMP, we carried out a survey to examine those issues.

Anglophones do not retain their level of proficiency in French

23.71 The recruit official languages training program meets the spirit and intent of the Official Languages Act. However, the current program may not work well for Anglophones.

23.72 Most Anglophone graduates reported that their French language proficiency had deteriorated during basic recruit training, although bilingual instructors and courses are available in French at the Training Academy. As for Francophones, the majority of whom take their basic recruit training in English, there was concern that "B" level proficiency in English may not be adequate to allow them to work easily as police officers in largely English–speaking detachments. The same issue was raised by Anglophones surveyed about the adequacy of "B" level proficiency in French.

23.73 The main problem for Anglophones is that, when they graduate from the Academy, more than half are posted to detachments where they have no opportunity to speak and retain their French. Resolving the problem is difficult for the Force because it has a limited number of bilingual locations to place graduates who have completed the language training program. Nevertheless, given the cost and time expended to date on the program, it is essential that the investment in language skills be protected. Graduates must assume a degree of responsibility for maintaining their level of language proficiency. Furthermore, the Force must ensure that its limited number of bilingual positions are used to the best advantage in retaining that capability.

23.74 In its current review of the recruit official language training program the RCMP should address the initial posting of Anglophones and the adequacy of the current level of language proficiency requirements.

RCMP response: Agree.

Refresher Training

Members do not receive enough refresher training in some basic policing skills

23.75 Police forces across Canada are showing more interest in ongoing refresher training in areas essential to day–to–day police work. Training in areas such as first aid, cardiopulmonary resuscitation (CPR) and self–defense is seen as interrelated and complementary in protecting police

Police forces across Canada are emphasizing key basic skills in refresher training.

officers and serving the public effectively. Police forces we surveyed have recently embarked on mandatory survival or self–defense refresher training for officers. Instruction includes areas such as controlling the use of force, "verbal judo" (techniques for avoiding physical conflict) and the use of the police baton.

23.76 The RCMP has produced short videotapes that are made available to all members, and that deal with subjects such as self–defense and use of force. It has policies for regular recertification in firearms and first aid/CPR. Divisional policies require members to recertify annually in firearms and every three years in first aid/CPR. Our survey of three divisions (which collectively account for almost half of the RCMP's uniformed workforce) indicated that from 17 to 32 percent of the operational members had not received refresher training in the use of firearms. In first aid and CPR, less than half had requalified within the required three year period. Furthermore, despite a strong perceived need for it in the field, the RCMP does not provide refresher training in self–defense including areas such as conflict avoidance and verbal judo. The Force has indicated that it is taking steps to address these deficiencies.

Periodic refresher training is essential to maintaining basic skills (see paragraph 23.75)

23.77 The RCMP should review its refresher training and recertification practices to:

- **ensure compliance with existing policies in first aid, CPR and firearms training; and**
- **improve training in self–defense.**

RCMP response: *Agree.*

Member Orientation

The Force provides orientation programs for new recruits and other members

23.78 The RCMP's "back to the people" agenda, particularly community–based policing, requires that officers know and understand the language, culture, and particular characteristics of the communities they police. This knowledge and understanding are especially important for officers working in native communities. A knowledge of subjects such as local aboriginal cultures, traditions and spiritual matters provide an important introduction to the special needs of these communities.

23.79 The RCMP has a Force–wide orientation training policy that focusses primarily on familiarizing the officer with the infrastructure of the detachment and with the job. This national policy provides general guidelines to the divisions. Less emphasis is placed on the officer's orientation to the unique cultural and social characteristics of a particular community.

23.80 In the three divisions we surveyed, we found that orientation packages in non–native communities varied widely in the depth and quality of orientation provided. While some detachments simply complied with the Force–wide orientation training policy, others complemented these national guidelines to better reflect the community being served. We also found that the RCMP had begun to work on improving its orientation program for detachments policing native communities. This work was in its preliminary stages. Although a certain degree of flexibility is needed in the design and implementation of specific orientation programs at the divisional level, national standards may also be required.

23.81 The RCMP should re-examine its national policy for unit orientation training to build on current initiatives and to better meet the principles of its "back to the people" agenda.

RCMP response: *Agree.*

Career Management

Performance Evaluation

There are difficulties with the new performance evaluation system

23.82 The RCMP has recently introduced a new system for evaluating the job performance of its members. Evaluations are done annually, and they play a large role in deciding who gets promoted and transferred.

23.83 One of the key weaknesses of the system is that it evaluates all employees against seventeen performance standards (for example, supervisory skills, attentiveness to duty and organizational awareness) regardless of the job the employee is doing. All standards are given equal weight in assessing an employee. This practice makes little sense because, for example, supervisory skills may not be particularly important to a constable in contract policing but very important to a contract policing staff sergeant commanding a detachment. Other police forces that do not have the wide range of responsibilities of the RCMP have tailored their evaluations to specific jobs.

23.84 A second weakness is that supervisors often lack the training and guidelines they need to apply the performance standards consistently when evaluating their employees.

23.85 The RCMP should improve its performance evaluation system by developing performance standards and weighting systems that are more job–specific, and by ensuring that all supervisors are given appropriate performance evaluation training and guidelines.

RCMP response: *Agree.*

The promotion process is being rethought.

Promotion

23.86 The five main steps in promoting uniformed, non–commissioned members (corporals, sergeants, staff sergeants) are shown in Exhibit 23.6.

The promotion system does not focus on requirements of future jobs

23.87 The RCMP's current system for assessing promotability focusses almost entirely on seniority and on how well one has performed in his or her current job, or at a given level. It does not sufficiently take into account how well an individual would perform at the next level.

23.88 As can be seen in Exhibit 23.6, the second step assigns a 35 percent

Exhibit 23.6

RCMP Promotion Process

1. **Promotability Assessment** – Immediate supervisor assesses according to satisfactory performance and general criteria for promotion potential.
2. **Long list** of candidates – Promotable, interested candidates are ranked by computer according to past performance (65 percent) and seniority (35 percent).
3. **Medium List** of candidates – The top 15 or 15 percent of candidates on the long list are selected by a staffing officer based on training, experience and past performance in relation to basic job requirements.
4. **Candidate Short List** – The top five candidates are selected by a staffing officer based on past performance and experience in relation to desirable job qualities.
5. **Final Selection** – The most qualified candidate is chosen by a Board, according to a file review of the top five candidates.

value to seniority in ranking a candidate on the "long list". Other police forces emphasize seniority to a lesser extent; some use seniority only as a prerequisite to (rather than a basis for) ranking. They use objective standards, interviews, examinations and other methods to evaluate a person's ability to perform at a higher level.

23.89 It might be possible for the Force to save a substantial amount of money if it were to use a more rigorous system for managing promotions. For example, a recent study conducted by the Canadian Police College has indicated that if the RCMP were to replace its current promotion practices with a highly structured, forward–looking interview process when promoting to the inspector level, it could realize productivity gains of about $15 million annually.

Promotions are not well supported

23.90 Inconsistency and subjectivity exist in establishing the medium and short lists for promotions. The qualifications considered desirable for a particular job vary among staff members and among divisions, as does the weighting given to certain qualifications. Very little information is retained on file to justify selection decisions.

23.91 The standards used by the Board to assess and compare short–list candidates for promotion are unclear. Our review of promotion practices and files did not provide evidence of a systematic comparative assessment of candidates. At times, the Board applied criteria that were not listed for the job in question.

23.92 Deficiencies in the promotion process have produced grievances. Close to half of the 794 grievances filed in 1990–91 related directly to promotions. Approximately 30 percent of such grievances have been upheld due to the excessively subjective nature of the promotion process. The reasons for upholding grievances often include inappropriate or inconsistent application of selection criteria; selection criteria listed in the qualification schedules that were too broad; failure to note a skill; and insufficient reason for not choosing a candidate.

23.93 The RCMP has begun to comprehensively review its current promotion system. It has established a "best practices" committee in order to identify possible improvements.

23.94 **We will review the progress in this area when we do our follow–up audit and reassess how the RCMP uses performance evaluation results in promotion decisions.**

RCMP response: Agree.

Career Information

Employees need more information for "mapping" their careers

23.95 Within the RCMP there are about 1,000 different jobs that members perform — from flying airplanes to programming computers to investigating commercial crimes. To prepare for promotion or transfer, employees need comprehensive information on the skills, aptitudes, education, training and other qualifications associated with specific jobs. The RCMP has recognized the benefits to employees of enabling them to plan their own career paths to a greater extent, and has distributed a career management manual to assist them. However, some of the information is lacking because the Force has not analyzed most jobs to determine the skills and aptitudes necessary. As a result, individual employees have trouble planning their own career paths — that is, making decisions that would enable them to do what is necessary to train or otherwise qualify for another job. As indicated in paragraphs 23.21–23.22, the Force has begun to analyze a number of positions to determine the tasks, qualifications and prerequisites associated with each.

23.96 When the task analysis is complete, the Force should be able to provide members with the information they need to "manage" their careers more proactively.

Physical and Psychological Health

23.97 Physical fitness and psychological health directly relate to a police force's operational effectiveness. Police departments across North America have recognized this fact and are starting to put programs in place to cover these areas.

Physical Abilities

The RCMP has developed a job–related physical ability test that is administered to recruits

23.98 In 1989 the RCMP developed the Physical Ability Requirement Evaluation (PARE) test to measure the physical ability of its uniformed members. Most of the tests done so far have been on recruits hired after 1 January 1991. The test is also administered to uniformed members in tactical troops and bomb squads.

23.99 At present, the RCMP has not used the test to determine the physical abilities of most of its regular uniformed members. The Force does not know what proportion of all current uniformed members could pass the PARE test.

23.100 While the RCMP is among the leading police forces in Canada in the development of a valid physical ability test, some other police departments are more advanced in introducing programs to actually improve their members' lifestyle and physical fitness. The RCMP has chosen to proceed carefully in developing a similar program for 1993–94, which would apply to all its members.

23.101 Because the Force is aging (average age increased from 32 to 37 years between 1980 and 1991) and because the current PARE test has been applied mainly to new recruits, it is important that the Force move as quickly as possible to assess the physical abilities of the majority of its members.

The new physical abilities test is to be applied eventually to all members.

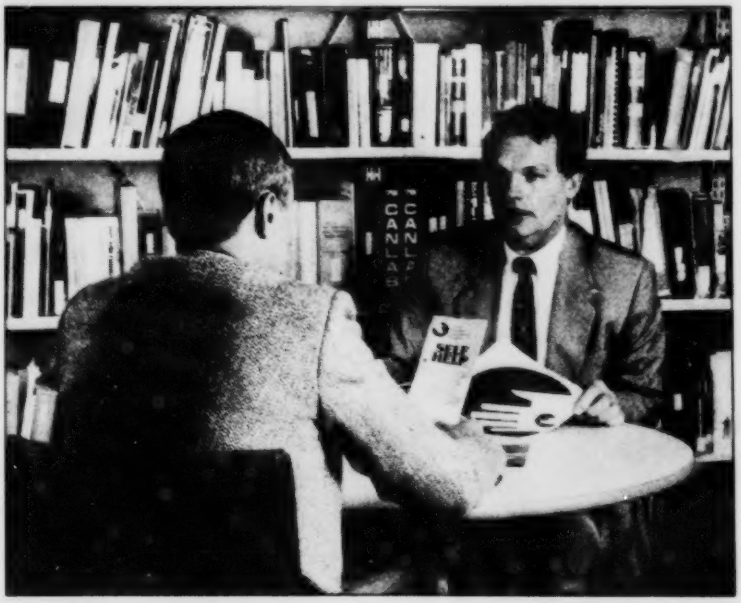
23.102 Because physical ability and fitness are key aspects of a member's ability to perform operational duties, we will review the implementation of PARE testing again during our follow–up.

RCMP response: Agree.

Psychological Wellness

The RCMP does not have enough information to assess the overall success of its psychological wellness program

23.103 Our survey of police departments and related literature have allowed us to define a comprehensive psychological wellness program as one that includes job–related guidelines or standards for psychological wellness; reactive programs to assist officers in need; preventive programs to reduce



An effective program that ensures psychological wellness is critical in police work (see paragraph 23.103).

future problems; and management information to monitor success.

23.104 The RCMP has comprehensive psychological wellness programs that provide reactive and preventive assistance in such areas as post–critical incidents, suicide prevention and medical support for undercover operations, as well as examinations for members involved in high–risk duties. The RCMP also has a Member Assistance Program, which complements all health service activities.

23.105 The RCMP has some broad guidelines for psychological health that do not clearly specify job–related psychological traits. Although it is difficult to identify the psychological traits characteristic of a good police officer, it is possible to determine traits that are not. The results of the current RCMP Task Analysis project will assist in identifying specific job–related psychological traits.

23.106 The RCMP has had some difficulty assessing the success of its psychological wellness programs for members. Specifically, it does not know how successful its Member Assistance Program has been across the Force, in terms of its usefulness and the extent to which it is actually used.

23.107 Our interviews indicated that many programs were operating with varying success across RCMP divisions. Some of the divisional Member Assistance Programs were functioning well and others were not. Also, the psychological examinations relating to the Force's High Risk Duties policy were administered differently in different divisions. The Force has stated that it recognizes this problem and is in the process of addressing it.

23.108 The RCMP should improve its ability to assess the effectiveness of its psychological wellness program for members.

RCMP response: *Agree. The RCMP is currently enhancing its data collection system to gather more comprehensive information on the frequency, results and follow–up of their psychological wellness program.*

Chapter 24

Emergency Preparedness in the Federal Government

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Emergency Preparedness in the Federal Government

Assistant Auditor General: Len McGimpsey
Responsible Auditor: Alan Gilmore

Main Points

24.1 We reviewed emergency preparedness in the federal government. We initially reported to Parliament on this area in 1987, and in 1990 the Standing Committee on Public Accounts requested us to review progress to date.

24.2 In general, long–standing problems in federal emergency planning are not being addressed within a reasonable time frame. For example:

- Five years after we raised the issue, the general part (Part I) of the National Earthquake Support Plan (NESP), which provides a framework for further planning, is nearing completion. However, Part II of the NESP — departmental emergency support function plans — is still being worked on.
- The Department of the Environment informed Cabinet in June 1991 that although a few of the recommendations of the 1986 Bhopal Aftermath Report have been implemented — for example, the establishment of the Major Industrial Accidents Council of Canada (MIACC) — there has been no follow–up action on most of the other important recommendations.
- A 1986 review of the Chernobyl experience recommended major improvements to the federal government's nuclear emergency response plan. Most of these have not been implemented or are in the early stages of development. Revision of the plan should be a priority.
- Mandates for departmental lead roles in emergency planning still need clarification and interdepartmental co–ordination still needs improvement.

24.3 We are concerned that the delays in developing co–ordinated plans for major emergencies will reduce the speed of the emergency response, which is a critical factor in saving lives and protecting property.

24.4 In our opinion, the delays are the result of several factors, including interdepartmental jurisdictional disputes, allocation of resources to other priorities, the complexity of co–ordinating plans with the provinces, and a lack of a sense of urgency, perhaps due to the absence of a recent major disaster in Canada.

24.5 The information provided to Parliament on the status of emergency preparedness on a government–wide basis is inadequate. The government's budget proposals calling for the ending of the requirement for annual departmental reports could almost eliminate disclosure of this information to Parliament unless an alternative method is used.

Introduction

24.6 Our 1987 Report presented the results of our audit of federal peacetime emergency planning. We reported: an absence of legislative authority and organizational structures for federal peacetime emergency planning; a lack of clear milestones, which made it difficult to assess the extent to which departments had implemented arrangements to establish the National Emergencies Agencies required by the 1981 Emergency Planning Order; and an absence of planning for certain potential national disasters.

24.7 The Emergencies Act and the Emergency Preparedness Act were passed by Parliament in 1988, and the War Measures Act and the Emergency Planning Order were revoked. The Emergency Preparedness Act assigns specific responsibilities to Emergency Preparedness Canada (EPC), which was established as a department in 1988 to develop and co–ordinate civil emergency planning. The Act requires an annual report to Parliament on the status of emergency planning. It also requires ministers to identify the civil emergency contingencies that are within or related to their areas of accountability, to develop civil emergency plans and to conduct training and exercises. The Emergency Preparedness Act also introduced the concept of national emergency arrangements that made planning for a war crisis a subset of wider emergency planning activities.

24.8 The Emergencies Act gives the government exceptional powers to deal with public welfare, public order, war and other international emergencies. The use of these powers is reserved for situations that seriously endanger Canadians or threaten the ability of the government to survive. The Act stipulates that such a situation must be beyond the authority of the provinces and one that cannot be effectively dealt with under any other law. It also requires consultation with the provinces as to whether a national emergency exists.

24.9 Our 1989 Report presented the results of the follow–up of the 1987 audit on emergency preparedness. It reported that EPC had improved departmental co–ordination in planning. Examples included the Federal Working Group on National Earthquake Preparedness and the development of a draft national earthquake plan. However, the audit noted that goals and deadlines for national emergency planning were not adequately stipulated, and recommended that EPC should provide specific advice to departments about roles and responsibilities, resource allocations, and shortcomings.

The 1988 Emergency Preparedness Act requires ministers to identify and plan for civil emergencies related to their areas of responsibility.

The Standing Committee on Public Accounts

24.10 The Standing Committee on Public Accounts (PAC) reviewed our report on 30 January and 1 February 1990. Its Fifth Report to the House of Commons for the fiscal year ended 31 March 1989 made several recommendations for improving federal emergency planning. The PAC also requested that the Auditor General assess the government's response to the Committee's recommendations.

24.11 The Public Accounts Committee's report contained recommendations for action by EPC with a response required by 31 March 1991. The recommendations include the following:

- EPC should adopt a formal plan, with milestones for assessing progress, to designate lead agencies for specific national emergencies through the adoption of orders and regulations under the Emergency Preparedness Act.
- EPC should improve guidance to departments by identifying their roles and required levels of

Our 1989 Report noted that goals and deadlines for national emergency planning were not adequately stipulated.

A 1990 report of the Public Accounts Committee recommended that goals and deadlines be established for the completion and testing of emergency plans.

response for specific national emergencies.

- EPC should complete a National Earthquake Plan in conjunction with the provincial authorities as soon as possible.
- EPC should work with the departments involved in national emergency arrangements to ensure that goals and deadlines are established for the completion and testing of all emergency plans.
- The government should ensure that the departments responsible for national emergency arrangements provide EPC with achievable dates for the completion of their emergency plans and adhere to the milestones set for the completion and testing of these plans.

24.12 Since the PAC's report, the government has proposed changes in the organization and approach to emergency preparedness. In its February 1992 Budget, the government announced its intention to again make EPC part of the Department of National Defence (DND). At the time of writing, the final organizational details had not yet been settled. The Budget proposal may eliminate the requirement for annual departmental reports to Parliament; as a consequence, the section of the Emergency Preparedness Act requiring such a report may be repealed.

In Canada, the municipal, provincial and federal governments share responsibility for emergency planning

24.13 The first responsibility for responding to an emergency rests with the municipality. If the emergency extends beyond the capacity of municipalities, responsibility passes to provincial governments; and if the problem is beyond their capacity, provinces can request federal involvement.

24.14 It is important to take this division of responsibility into account because it places limits on the extent of detailed emergency planning that can be done at the federal level. It also requires the co–operation of all levels of government to ensure that emergency plans, policies and procedures are complementary.

Audit Objectives and Scope

24.15 We reviewed emergency planning in the federal government for major peacetime emergencies that could involve requests from provincial governments for significant assistance, as well as the government's response to the recommendations of the Public Accounts Committee. We examined emergency preparedness and applicable measures to prevent or reduce loss from earthquakes, nuclear accidents, and marine and non–marine chemical and oil spills. We reviewed the work of Emergency Preparedness Canada, the Department of Transport, particularly the Canadian Coast Guard, and the departments of the Environment, Employment and Immigration, Communications, National Defence, Health and Welfare, Energy, Mines and Resources, and Industry, Science and Technology. We reviewed information from the Atomic Energy Control Board; however, we did not conduct an operational review of its regulatory activities. We also reviewed emergency planning for public order and wartime crises insofar as the activities in these areas relate to peacetime capabilities.

24.16 We did not review implementation of the Transportation of Dangerous Goods Act by the Department of Transport, emergency planning for epidemics, or emergency planning for floods, tornados and forest fires. Nor did we review the role and capability of voluntary agencies such as the Canadian Red Cross. An additional caveat should be made. In certain instances in the report we refer to statements made by departments.

These statements represent the views of the departments on the issues we have raised. They are included in the report to provide a context for our findings and an indication of the actions planned by departments.

General Assessment

Room for significant improvement

24.17 **We found that, in general, long–standing problems in federal emergency planning were not being addressed within a reasonable time frame.** We are concerned that the delays in developing co–ordinated plans and supporting arrangements for major emergencies will reduce the ability of the government to effectively respond to major disasters. For example:

- Five years after we raised the issue, the general part (Part I) of the National Earthquake Support Plan (NESP), which provides a framework for further planning, is nearing completion. However, Part II of the NESP — departmental emergency support function plans — is still being worked on.
- The Department of the Environment informed Cabinet in June 1991 that although a few of the recommendations of the 1986 Bhopal Aftermath Report have been implemented — for example, the establishment of the Major Industrial Accidents Council of Canada (MIACC) — there has been no follow–up action on most of the other important recommendations.
- A 1986 review of the Chernobyl experience recommended major improvements to the federal government's nuclear emergency response plan. Most of these have not been implemented or are in the early stages of development. Revision of the plan should be a priority.
- Mandates for departmental lead roles in emergency planning still need clarification and inter-departmental co–ordination still needs improvement.

24.18 These delays may reduce the speed of the emergency response, which is a critical factor in saving lives and protecting property. Roles, responsibilities and procedures must be agreed upon in advance. The need for action was underlined by a recent national emergency exercise indicating that significant problems exist in federal preparedness for major emergencies. Our report discusses the results of an evaluation of the exercise and the steps taken to respond to some of the key problems identified.

24.19 In our opinion, the delays are the result of several factors, including inter–departmental jurisdictional disputes, allocation of resources to other priorities, the complexity of co–ordinating plans with the provinces, and a lack of a sense of urgency, perhaps due to the absence of a recent major disaster in Canada. Our detailed findings and conclusions follow.

Departmental Responsibilities

Departmental lead role mandates need to be clarified

24.20 The PAC expressed its concern that departmental responsibilities be clear and that "emergency planning clearly identify who is in charge and jurisdictional conflicts between federal agencies be avoided. It is essential that response to a disaster not be delayed by such problems."

24.21 In March 1991, EPC told the Committee "that the more important consideration is the designation of lead ministers for emergency planning with respect to functional areas relating to the adverse effects of emergencies. This is being addressed in the proposed Civil Emergency Preparedness

We found that, in general, long–standing problems in federal emergency planning were not being addressed in a reasonable time frame. These delays may reduce the speed of the emergency response, which is a critical factor in saving lives and protecting property.

Until recently, there has been very little progress in co–ordinated interdepartmental emergency planning for major oil and chemical spills, nuclear accidents and earthquakes.

Management Order now being drafted, which will designate lead ministers for functional planning in twelve areas. Consultations with departments on the latest draft of the order are now in their final stages, and it will be submitted to Cabinet soon."

24.22 The proposed Order focussed on re–establishing the departmental lead roles and responsibilities identified in the 1980 Federal Policy on Emergencies and the 1981 Order–in–Council. The Order–in–Council was revoked in 1987.

24.23 The process to develop the Order was initiated in the fall of 1988. EPC believed it was needed because, with very few exceptions, the planning responsibilities of departments with respect to emergencies were not covered elsewhere. However, the Privy Council Office preferred to use Cabinet administrative authority rather than a statutory instrument to designate lead departments and responsibilities for specific sectors of emergency planning. The Privy Council Office believed that ministerial responsibilities are already defined in applicable laws and statutory instruments. In addition, key departments objected to using the 1981 roles and responsibilities as the basis for the Order.

24.24 As a result of the disagreements, the development of the Order was cancelled in January 1992 in favour of a comprehensive policy review.

Interdepartmental co–ordination still needs to be improved

24.25 There are two main interdepartmental committees on emergency planning: the Ministers Advisory Committee on Emergency Preparedness (MACEP) and the Interdepartmental Co–ordinating Committee (ICC). MACEP is responsible for overall direction, while the ICC focusses on co–ordination of more detailed planning. There are a number of sub–committees that focus on specific concerns. The committees cover a wide range of issues and generally convey useful information to participants.

24.26 In late 1989 the Ministers Advisory Committee began to establish broad priorities for government–wide emergency preparedness. It established a list of government–wide priorities in mid–1991. An EPC survey of departments completed in early 1992 found that somewhat more than half of departmental emergency planning activities related to the MACEP–approved priorities. EPC has also improved its monitoring of departmental progress in emergency planning.

24.27 However, until recently, there has been very little progress in co–ordinated interdepartmental emergency planning for major oil and chemical spills, nuclear accidents and earthquakes. For example, departments have only recently agreed upon a basic management structure to deal with earthquake emergencies, and interdepartmental emergency planning for major oil and chemical spills is in the beginning stages. Departments are beginning to enter into bilateral and multilateral memoranda of understanding that define reciprocal responsibilities for specific situations, or to establish interdepartmental committees to sort out responsibilities.

24.28 EPC assured the PAC that "jurisdictional problems occur only rarely and then in the context of the division of responsibilities between federal, provincial and municipal governments." However, EPC's evaluation of CANATEX — a major exercise to test preparedness for a national emergency involving international events — found a probability that there are overlaps of authority, responsibility and resource requirements across national emergency agencies (NEAs), between NEAs and their parent departments, and between NEAs and the central agencies.

24.29 The report noted that, without identification and resolution of overlaps in responsibilities, the overlaps will create confusion when it is least desirable. For example, there could be competing demands for the same resources during a crisis.

Emergencies Act

Debates about the usefulness of the Emergencies Act

24.30 An objective of the Emergencies Act is to provide a sound mechanism for declaring a national emergency, one that would not be regarded as abrogating civil rights, parliamentary prerogatives, or authorities of other jurisdictions and would be reasonably easy to invoke in the appropriate circumstances.

24.31 Some departments have expressed concern that the Emergencies Act may not be used by the government to declare a national emergency because of the requirements in the Act for provincial consultation and parliamentary debate and oversight. Without such a declaration, they believe they will not have the authority to immediately and effectively respond in a crisis. Some departments are considering identifying the additional authorities they would need to act in a national emergency in the absence of a declaration or in the face of an escalating crisis; they believe that the Emergencies Act should be revised. The Department of Justice has indicated that this area warrants further examination.

24.32 The Department of National Defence, which now includes EPC, has the primary responsibility for determining whether the legislation warrants amendment. EPC believes that these concerns are unwarranted and that departments may needlessly reduce efforts to prepare for major emergencies because of their concerns. EPC believes that if departments' concerns are valid, the concerns could easily be addressed by preparing draft special legislation as part of departmental emergency preparedness efforts.

CANATEX and Related Issues

24.33 As indicated above, CANATEX involved a wide range of departments carrying out assigned tasks. EPC says its strategy is to use such exercises to test plans and advance federal, provincial and private sector planning by a specific date. CANATEX was the first of these exercises. Although it represents an assessment of the current state of emergency preparedness for national emergencies involving international events, some of its results have applicability to peacetime emergencies.

24.34 CANATEX was generally regarded by departments as a useful exercise. Many departments observed that the exercise had improved understanding and heightened the awareness of departmental senior management concerning the need for senior–level involvement.

24.35 However, departments and EPC agree that the usefulness of the exercise was reduced because:

- key departments did not fully participate in the exercise as a result of their Gulf Crisis responsibilities; and
- regional and functional capabilities of departments were not tested.

24.36 In addition, major departments felt that the usefulness of CANATEX was further limited because it focussed on carrying out five major activities rather than responding to a predetermined scenario of unfolding events. However, EPC believes that the absence of a pre–determined scenario created a more realistic test of departmental capabilities because of the element of unpredictability.

CANATEX noted that, without identification and resolution of overlaps in responsibilities, the overlaps will create confusion when it is least desirable.

24.37 The EPC review of the CANATEX exercise was reviewed by departments, including the Privy Council Office (PCO). The PCO indicated in March 1991 that it was inappropriate to ask ministers to consider recommendations resulting from CANATEX in the absence of any assessment as to whether the exercise's findings had been validated by the issues that arose during the Gulf Crisis. It recommended that the results of CANATEX be reconsidered in light of the Gulf War experiences, and noted that it was of paramount importance that this analysis be rigorous and all–encompassing. We found that such an assessment had not been conducted. We reviewed departmental reports on lessons learned from the Gulf Crisis as they relate to general emergency preparedness. With the exception of DND, most departments indicated that their capability was not tested to any significant degree.

CANATEX identified significant problems in the federal emergency planning system.

Results of CANATEX indicate the need for major improvements

24.38 EPC conducted a post–exercise evaluation of CANATEX. The results of the evaluation and the steps taken to remedy certain problems are discussed below. CANATEX identified significant problems in the federal emergency planning system. In general, departments are in agreement with the findings of the evaluation. The problems identified included:

- an absence of an up–to–date and complete government emergency book informing departments of what steps to take in the event of an emergency;
- a lack of departmental emergency books informing staff of their responsibilities and the steps to take in the event of an emergency;
- a lack of secure telecommunications;
- inadequacies in civil industrial preparedness; and
- a lack of stated government policy on whether to continue to support public protection measures initiated in the 1950s in response to a threat of nuclear attack, including the warning system, the public shelter program, and radiation monitoring, which are generally in poor condition.

Communication management needs to be improved

24.39 The CANATEX exercise also indicated a serious problem in identifying critical communications related to an emergency, in establishing priorities and in ensuring that high–priority, time critical communications were expedited through the system. Critical CANATEX–related communications were often buried in the huge volume of normal day–to–day correspondence. The resolution of this problem is dependent on improved training of departmental personnel who originate, transmit and receive messages.

Concerns about government crisis management machinery exist

24.40 CANATEX also explored whether the decentralized and reactive peacetime mechanism that has evolved in the federal bureaucracy could provide for effective crisis management. According to the CANATEX evaluation, there are concerns as to who would take charge of the federal apparatus in a major emergency to activate alert systems, co–ordinate policy, establish priorities and issue directions.

24.41 There is a debate within the government as to whether the central crisis management machinery of government is adequate. The current overall federal structure for crisis management is based on the concept of flexible response, with ad hoc committees of ministers and deputy ministers and mirror committees of lower officials to be created as required.

24.42 The Privy Council Office believes that this approach works well and that the inadequacies identified in the exercise reflect the design of, and the constraints on, the CANATEX exercise.

Response to CANATEX

24.43 Steps have been taken to respond to some of the concerns identified by CANATEX. For example, departments have acquired secure facsimile and telephone services, and EPC has been co-ordinating the development of a Government Emergency Book. The Privy Council Office has undertaken to draft the crisis management section of the Book.

24.44 The Department of Industry, Science and Technology has formed an interdepartmental committee to address the problems of industrial preparedness, although it indicates that its formation was in response to events arising from the Gulf Crisis.

24.45 In response to the issue of maintaining a warning system, the Department of Communications states that the government intends to rely on available telecommunication facilities to inform the public of emergency situations, rather than set up its own system.

24.46 The Government Emergency Book is a prerequisite to resolving many of the other key concerns. It has been under development for about two years and EPC says that it will be completed in December 1992. However, there are significant debates among departments as to what the book should address.

Medical Stockpiles

24.47 The Department of National Health and Welfare (NHW) maintains a stockpile of medical supplies and equipment. About 50 percent of the supplies are in seven depots run by the Department of National Defence and the remainder are at 1,150 sites across the country. NHW estimates that the replacement value of these supplies is about $200 million and spends about $1.4 million each year to manage and operate the stockpile. The locations of stockpiles are determined by the provinces, which have the responsibility to maintain and inspect them.

24.48 A 1986 departmental internal audit found that the equipment was in generally sound condition and that the stockpile was still required. A study published by EPC in 1988 found that the stockpile was still required and that it should be expanded. However, a subsequent 1989 departmental internal audit found significant concerns among federal, provincial and non-governmental agencies about the contents, locations and maintenance of the stockpiles in 1,150 nationwide sites. The 1989 audit also recommended that the Department study the effectiveness of having stockpiles at the sites. The 1988 and 1989 assessments differ significantly on the usefulness of the stockpiles. Although the differences have not been resolved, the Medical Services Branch of the Department, in response to the 1988 study, and in conjunction with the provinces, has begun a preventive maintenance and refurbishing program, which the Branch believes will also lead to the rationalization of the sites.

Information to Parliament

The disclosure of information on the status of emergency preparedness is not adequate

24.49 As indicated above, the government's budget proposals could eliminate the requirement for an annual report on the status of emergency preparedness on a government-wide basis. Such information should be made available to Parliament, possibly by including it in DND's Part III Estimates.

24.50 At the PAC's request, our Office reviewed information on the status of emergency preparedness provided to the Committee and

We found that the information to Parliament identified what each department is doing, but it did not indicate how these actions fit into an overall departmental or government–wide plan to reach a capability to respond to major emergencies.

Parliament. We found that the information identified what each department is doing, but it did not indicate how these actions fit into an overall departmental or government–wide plan to reach a capability to respond to major emergencies. Nor does it provide information on the major issues that still need to be resolved; for example, the problems with the Federal Nuclear Response Plan described below.

Preparedness for Major Disasters

24.51 The preceding sections of this chapter have addressed generic issues in federal government emergency planning. The following sections discuss the government's capability to respond to earthquakes, nuclear emergencies and oil and chemical spills.

Earthquakes

Background

24.52 The Geological Survey of Canada (GSC) in the Department of Energy, Mines and Resources indicates that since the time of European settlement (about 150 years ago) there have been six earthquakes measuring 6 to 7 on the Richter scale within 150 kilometres of downtown Vancouver. The National Building Code design standards for the Vancouver area reflect this experience.

24.53 The GSC also indicates that there is a "subduction zone" under Vancouver Island. A subduction zone is an area where a plate of the earth's crust is moving under another segment of the crust. According to the GSC, this motion is not continuous but periodic in certain circumstances. That is, plates may be temporarily locked together by friction until enough stress builds up to cause a sudden rupture.

24.54 The GSC indicates that the oceanic crust in the subduction zone under Vancouver island is similar to that in six other locations in the Pacific. At five of these locations there have been mega–earthquakes in recorded history. The latest occurred off the west coast of Mexico in 1985 and caused severe damage. Another characteristic common to these subduction zones is the lack of minor earthquakes along the interface between the plates. The GSC reports that the seismic network on the west coast has not detected any seismic activity on the interface underlying Vancouver Island. Other evidence also suggests that the plates are stuck.

24.55 The subduction zone extends from northern California to northern Vancouver Island. A recent study off the coast of Washington state estimates that there is a 2 to 10 percent risk of a catastrophic earthquake in the subduction zone in the next 50 years.

24.56 The GSC would like to accelerate studies for the Vancouver Island area to determine if there is evidence to indicate that such large events could occur in the area. It would do this by improving the monitoring network to determine where and how rapidly strain is accumulating in the earth's crust. However, the GSC states it has limited funds for these and related projects. Based on available information, the GSC is planning to upgrade the seismic zoning maps to include the effects of the catastrophic earthquake in the 1995 revision.

Losses due to earthquakes

24.57 A recent study examined the economic impact of a major earthquake in the lower mainland of British Columbia having a magnitude of 6.5 on the Richter scale. The magnitude of the earthquake considered in this study is significantly below the level of a "catastrophic" earthquake, but is typical of what has occurred historically on a regular basis in the region.

24.58 The study estimates that fatalities may be in the low hundreds, serious injuries in the several hundreds and economic losses in the several billions of dollars. Actual losses would, of course, vary depending on the strength of the earthquake and when and where it occurred. In addition, since such studies are subject to methodological and resource constraints, the results should be viewed as giving only a general idea of the magnitude of losses.

24.59 The study also suggests that further detailed economic and vulnerability analyses of such critical structures as schools, hospitals, bridges and water, sewage and electrical systems are needed for governmental and corporate decision making. The question of who will conduct and fund these studies has been a long–standing issue among the several levels of government. The federal government, at one point, considered doing a rough set of estimates, but recognized that the responsibility belonged to the provinces. To date, preparedness planning has occurred largely without these estimates.

A study of the impact of a major earthquake in the lower mainland of British Columbia estimates that fatalities may be in the low hundreds, serious injuries in the several hundreds and economic losses in the several billions of dollars.

National Earthquake Support Plan

The National Earthquake Support Plan is a framework for more detailed planning; it is not an operational plan

24.60 In our 1987 Report we stated that little work had been done on developing an earthquake response plan. In January/February 1990 the Public Accounts Committee expressed its concern that a national plan for earthquakes be developed as soon as possible. In August 1990, EPC designated itself as the lead agency for development of the National Earthquake Support Plan (NESP). There have been several delays in developing the Plan resulting from disagreements over the management structure (concept of operations), the underestimation of the importance of logistics and the complexity of co–ordinating planning with the provinces. According to EPC, Part I of the Plan, which contains general departmental roles and responsibilities, should be approved by deputy ministers by the end of summer 1992. The completion of departmental emergency support function plans is expected by the spring of 1993.

24.61 The NESP is intended to be a national plan for providing assistance to British Columbia. However, it is not an operational plan. The National Earthquake Support Plan does not state what the response capabilities of the federal government and other governments are, or what level of assistance the federal government is supposed to give.

24.62 At the time of writing, the NESP had been discussed with government officials of British Columbia and Alberta. Other provinces have been informed of the plan but their participation has not been incorporated into it. We are concerned about this approach, since the Geological Survey of Canada indicates that there is also a significant earthquake hazard in Eastern Canada. The GSC has pinpointed the Ottawa and St. Lawrence valleys, New Brunswick and the south of Newfoundland as areas with significant earthquake hazards.

Urban Search and Rescue and Recovery Planning

24.63 The National Earthquake Support Plan does not assign responsibility for urban search and rescue in the event of a major earthquake and does not include recovery planning. Analyses of the assessment of earthquake casualty patterns referred to by DND in its earthquake response plan shows that over 96 percent of casualties who survive are rescued and treated within the first 24 hours. The Province of British Columbia's earthquake response plan assigns this responsibility to municipalities. The lack of a specialized urban search and heavy rescue capability has been frequently cited as a contributor to the loss of life in several recent earthquakes.

The National Earthquake Support Plan does not state what the response capabilities of the federal government and other governments are, or what level of assistance the federal government is supposed to give.

24.64 The NESP is not intended to address the issue of recovery after an earthquake. A plan for recovery needs to be developed.

Roles of the Departments of National Defence, Transport and Communications

24.65 In July 1992, DND agreed to assume responsibility for the establishment and operation of a national logistics management system that will co–ordinate and control the movement of required national resources into a designated disaster area. The implementation plan will provide the detailed operational direction to run seven staging areas across the country, up to five advanced holding zones within British Columbia and, if needed, up to 10 distribution points within the disaster area. The implementation plan is based mainly on the movement of goods by air, since it is not expected that ground transportation will be available in the critical response period.

24.66 A 1992 DND study concluded that the Department has adequate resources to fulfil its current responsibilities, to expand its operations in case of a major earthquake and to accept the role of managing logistics operations. The conclusion is based on the assumption that the majority of Canadian Forces units would be in their normal peacetime locations, available for rapid tasking, and that departments and agencies involved in the NESP would be prepared to operate for an extended period, perhaps as long as 30 days, 24 hours a day, 7 days a week.

24.67 DND is developing a complete logistics plan, and it estimates that a final draft will be sent to senior management for approval by December 1992. DND has also developed its own immediate earthquake response plan for British Columbia to co–ordinate actions of Canadian Forces in that province. That plan was approved in May 1991. DND would respond to requests for other support as part of its responsibilities for the provision of assistance to the civil authorities.

24.68 Pursuant to NESP, the federal government may be requested to provide all types of civilian transportation; however, it is uncertain whether the requested transportation can be provided. The NESP gives the Department of Transport overall responsibility for the provision of arrangements for civil transportation resources. Given its limited transportation resources and limited legislative authority, Transport states that it could fulfil this only role if the government invoked Part III of the Emergencies Act or by special order–in–council, which would allow it to allocate civilian transport. Transport states that it has already drafted the appropriate legislation that would lead to such an order–in–council.

24.69 **In the immediate aftermath of a catastrophic earthquake, communications are vital.** Existing communication networks would probably be destroyed in a catastrophic earthquake, and immediate communications would be limited largely to amateur radio operators. Partial restoration of the telecommunications network is expected to take a minimum of 48 to 72 hours. One alternative being considered by the Department of Communications, as an interim measure, is the use of the MSAT satellite after it comes on line in 1994. Communications believes that this would reduce, to some degree, the major disruption in service that would undoubtedly occur.

24.70 A recent report issued by EPC indicates that, with the exception of DND and the Canadian Coast Guard, most federal Pacific region departmental units have inadequate communications for a catastrophic event. In order to address the problem, the Department of Communications will be conducting a communications study to determine telecommunications needs.

CANATEX 2

24.71 Departments are working toward completing their planning for the April 1994 CANATEX 2 earthquake response exercise by the spring of 1993. The exercise was originally scheduled for early 1993. If it goes ahead in its present form, CANATEX 2 will involve a test of the federal, British Columbia and Alberta earthquake response plans. In May 1992 an exercise was held in British Columbia to identify and familiarize a federal regional earthquake support team with the provincial field response centre and the support services required. At the time of writing, Cabinet had not yet been asked to approve CANATEX 2.

Nuclear Emergencies

Background

24.72 The Atomic Energy Control Board (AECB), Canada's nuclear regulatory agency, is responsible under the Atomic Energy Control Act for inspecting and regulating nuclear materials throughout their life cycle. Its responsibilities include regulating the major nuclear reactors, the use of radioactive materials in industry and institutions and the transportation and disposal of nuclear radioactive wastes. We reviewed AECB information on nuclear safety and the prevention of nuclear accidents.

24.73 In 1989, the Treasury Board approved major additional funding for AECB to remedy problems in the regulation of Canada's nuclear industry. These problems are described below. The AECB recently informed us that, although it has largely completed hiring the authorized personnel, it would take several years to implement important improvements in regulatory enforcement and inspection programs. In 1992, the AECB informed Treasury Board that, on the basis of further review, its 1989 assessment was still valid; consequently, Treasury Board authorized a requested further increase in staff. According to the AECB, it expects that by the end of fiscal year 1993–94, satisfactory progress will have been made to correct the most serious shortcomings that still exist in the regulatory process.

24.74 With respect to the possibility of nuclear accidents at generating stations, AECB informed Treasury Board that, although it still concludes that nuclear power plants are acceptably safe, this does not mean they are risk–free. In support of its 1989 request for resources, the AECB stated, and a subsequent review commissioned by the Minister of Energy, Mines and Resources confirmed, that:

- the years of successful accident–free operation that are the hallmark of the Canadian nuclear program are not, by themselves, proof of adequate safety. CANDU plants cannot be said to be either more or less safe than other types of nuclear plants.
- it is now recognized that, through the combination of a series of comparatively common failures that, on their own, are of little consequence, accidents can develop in myriad ways.
- AECB's review of safety has been too simplistic. Spot checks of a fairly small number of key areas were thought to be sufficient. These spot checks uncovered enough safety problems to demonstrate that a more thorough review is essential, since the risk posed by nuclear power plants may be higher than once believed.
- each year there are a variety of significant events with safety implications at Canadian nuclear power plants. There is a significant backlog of required maintenance, operating documentation is out–of–date, inspections are incomplete and deficiencies in operating

With respect to the possibility of nuclear accidents at generating stations, the Atomic Energy Control Board informed Treasury Board that, although it still concludes that nuclear power plants are acceptably safe, this does not mean they are risk free.

plants may require design modifications.

Radiotherapeutic or Industrial Devices

24.75 A further group of events to be considered involves the loss or break–up of radiotherapeutic or industrial devices, such as occurred in Goiania, Brazil in 1987. In Goiania, the radioactive material in an abandoned medical irradiator was dispersed by a scrap metal dealer. Available information indicates that, of the 250 people who were exposed, 4 died and 28 were treated in hospital for radiation sickness. In the short term, there was an immediate adverse impact on local agricultural exports.

24.76 In 1989, the AECB informed Treasury Board that there were 3,300 licensed radioisotope users in Canada holding nearly 5,000 licences. It also reported that the number of inspections with unacceptable findings was steadily increasing. For example, the percentage of hospital inspections reporting licence violations rose from 7 to 40 percent between 1984 and 1988. In 1987, 33 percent of inspections of all radioisotope users revealed unacceptable conditions. Other AECB information indicates that there is virtually no prosecution of serious offenders.

24.77 In 1988 there were over 600,000 individual shipments of radioactive material in Canada, ranging from small quantities in standard industrial packages to very large and highly radioactive quantities in massive steel and lead containers. During that year, there were 42 reported incidents in which packages were lost, stolen, damaged or improperly shipped. AECB indicates that the safety of shipments is assured if the package is designed and used correctly. Practically no inspections have been made to ensure that the packages are used correctly. On the few occasions when inspections have been made, the rate of violations discovered indicates that there may be many shipments that do not meet prescribed safety standards.

Federal Nuclear Emergency Response Plan

The Federal Nuclear Emergency Response Plan needs to be significantly improved

24.78 The Department of National Health and Welfare (NHW) — the lead agency for the Plan — states that an ad hoc interdepartmental committee on nuclear emergency preparedness has been established to address the issues identified below.

24.79 The current Federal Nuclear Emergency Response Plan (FNERP) states that it covers emergencies that may arise off–site from nuclear generating stations in Canada and other countries, or from nuclear weapons testing, nuclear–powered devices, non–military nuclear–powered vessels and radioactive emissions that affect the public. Responsibility for dealing with nuclear emergencies is subject to the same provincial–federal jurisdictional roles as other emergencies. The Department of National Health and Welfare's role is based on an exchange of letters among the Prime Minister, the President of the Privy Council, the Minister for Emergency Planning, and the Minister for Health and Welfare during the period 1982 to 1984.

24.80 The impetus for federal action was the 1979 nuclear accident at Three Mile Island in Pennsylvania. The first version of FNERP was issued by NHW in 1984.

Concerns about the Federal Nuclear Emergency Response Plan

24.81 The FNERP was partially tested during the Chernobyl accident. The experience was reviewed by National Health and Welfare in 1986. The report, entitled "Review of the Federal Government Response to the Chernobyl, USSR, Nuclear Accident of April 26, 1986", made

24 recommendations for improvements to FNERP. For example, periodic full–dress rehearsals of the plan are needed; the objectives of the plan and the means to achieve them should be more clearly defined; the plan, with provincial concurrence, should clearly state who is to take the lead if accidents occur in the U.S.A.; the plan should include an appendix giving the target levels of radiation for various actions. Most of the recommendations, including the aforementioned, either have not been implemented or are in the beginning stages of implementation.

24.82 The Plan does not contain standard operating procedures that identify tasks, when they should be performed, and which specific staff positions should perform them. Also, NHW has not received departmental supporting plans for FNERP.

24.83 The provinces have primary responsibility for health and safety. The FNERP is not clearly linked to the provincial nuclear emergency plans. It should, to the extent possible, indicate what support and resources provinces would need in the event of a nuclear accident and where such resources might be obtained. Clear linkages are essential to ensure co–ordination in the event of an accident.

24.84 The Plan has not been tested in integrated interdepartmental, provincial and municipal exercises. However, it was partially tested during the Chernobyl accident, the 1988 Cosmos satellite re–entry incident and an exercise that focussed on air monitoring. National Health and Welfare states that the FNERP will be tested as part of its participation in an international exercise in the spring of 1993.

24.85 The Plan also does not provide guidance on the specific levels of radiation at which action should be initiated to protect against radiation exposure from contaminated air, water, soil and food.

24.86 Federal and provincial authorities need to agree upon standards for such matters as preventing damage to the thyroid through the distribution of stable iodine, deciding when to evacuate and shelter residents for the short or long term, and protection levels for food and water. The 1986 review by National Health and Welfare found that the entire area of radiation measurements and reference levels is in a state of "transition and confusion". It recommended that the Bureau of Radiation and Medical Devices take steps to establish realistic levels of radiation to protect the public. In December 1991 the Federal–Provincial Sub–committee on Radiation Surveillance agreed to standardize public protection levels for food and water. NHW states that consideration of draft standards for food and water has been indefinitely postponed while the Conference of Deputy Ministers of Health considers the future of its federal–provincial committee structures. However, it has indicated that alternative mechanisms will be explored to obtain the required consultation.

Most of the 1986 recommendations to improve the Federal Nuclear Emergency Response Plan either have not been implemented or are in the beginning stages of implementation.

24.87 In addition, the FNERP does not contain guidelines for dealing with the late stages of a nuclear emergency. Guidance needs to be developed, in consultation with the provinces, on responding to such problems as disposing of radioactive materials, cleaning up contamination of the food chain, water supplies and property, and re–entry to affected areas.

24.88 Together, Canada and the United States have about a dozen nuclear generating stations along the border. Responsibility for co–ordination with authorities in the United States needs to be clarified. A federal working group met on 27 May 1992 for the first time with its U.S. counterparts to establish co–ordinated communications.

The Federal Nuclear Emergency Response Plan has not been tested in integrated interdepartmental, provincial and municipal exercises.

24.89 Radioactive devices are used nationwide in medical facilities, universities and industry. Accidents involving such devices are the responsibility of licensees, AECB and the provinces. However, emergency planning for major accidents involving these devices must take into account that we would not know where an accident could occur and that, in general, there would not be any waiting period before action had to be taken. The FNERP does not cover accidents involving radioactive devices. Preparedness for such situations requires planning based on the capabilities of the provinces. In our opinion, a review should be undertaken by the federal government in consultation with the provinces to determine if FNERP should be expanded to include such accidents.

The Department of the Environment informed Cabinet in 1991 that a few of the recommendations of the "Bhopal Aftermath Review" have been implemented including the establishment of the Major Industrial Accidents Council of Canada. But no follow–up actions have been taken on most of the other important recommendations.

Accidents Involving Oil and Chemicals

24.90 Although Canada has legislation covering the Transportation of Dangerous Goods Act and the Workplace Hazardous Material Information System, unlike most modern industrialized countries it does not have a national legislative framework for chemical accidents. Such a framework would provide for requirements on the reporting of chemicals used by industry, preparation of on–site and off–site emergency plans, safety audits and reporting of spills. The Department of the Environment is assessing the need for such a framework.

24.91 The government's Green Plan recognizes that the possibility of chemical accidents is an inherent part of industrial society. In recent years, there have been a number of serious accidents worldwide, resulting in significant loss of life, property damage and damage to the environment. At home, Canadians have witnessed recent fires involving toxic chemicals at St. Basile–le–Grand, Quebec and tires at Hagersville, Ontario. The Department of the Environment estimated that it cost over $90 million to deal with these accidents. It also estimates that there are about 15,000 spills annually in Canada. In 1986, the last year for which data were analyzed, over 17,000 Canadians (1 in 1,500) were evacuated due to releases of chemicals, during several accidents. Most of these spills fall under provincial or municipal jurisdiction and polluters have the primary responsibility to respond. However, at least 30 percent or about 4,500 spills involve direct or indirect federal government responsibilities.

Bhopal

24.92 On 3 December 1984, a chemical accident occurred at Bhopal, India, that resulted in the deaths of over 2,000 people and injuries to tens of thousands more, and many additional deaths in the succeeding years. After this event, the Department of the Environment initiated a Bhopal Aftermath Review project.

24.93 The Department led an industry and government steering committee to examine the potential for Bhopal–type accidents in Canada. The March 1986 report, "Bhopal Aftermath Review", contained 21 recommendations. The recommendations were endorsed by the Department of the Environment's Consultative Committee in its report entitled "From Cradle to Grave: A Management Approach to Chemicals". The Department informed Cabinet in 1991 that a few of the recommendations, including the establishment of the Major Industrial Accidents Council of Canada, have been implemented, but no follow–up actions have been taken on most of the other important recommendations. The 1991–92 departmental initiatives described below address some of the more important recommendations directed to the federal government.

Major Industrial Accidents Council of Canada

24.94 As indicated, one of the important recommendations that has been implemented is the establishment of the Major Industrial Accidents Council of Canada (MIACC). The basis for MIACC is the Bhopal Aftermath Review's conclusion that the "possibility of a major industrial accident does exist" in Canada.

24.95 The Council is viewed by the federal government and others as an alternative to a strictly government–driven regulatory approach. It is supported by participation of officials and funds from the federal and provincial governments and industry; it receives an annual contribution of about $330,000 from the federal government.

24.96 Council members include federal and provincial agencies and various industry associations, for example the Canadian Chemical Producers' Association. However, representation from environmental or other public interest groups and certain industries, such as mining, smelter and pulp and paper, is low.

24.97 MIACC states that its objective is "to be a national focus and leader for co–operative action to reduce the frequency and severity of major industrial accidents involving hazardous substances". It defines a major industrial accident as an unplanned event that could occur during manufacturing, transportation, storage, use, handling or disposal of dangerous substances, and that may result in a release in such quantities so as to present a serious hazard to health, life, the environment or property beyond the limits of an installation or a transportation right–of–way.

24.98 The Council has undertaken a wide range of activities. To date, it has focussed on developing standards, guidelines, processes and co–ordination activities, for example, co–ordinating information systems containing data for handling dangerous substances and emergency medical information. Through the Canadian Standards Association, it has published a national standard on "Emergency Planning for Industry", and it is developing other standards and guidelines in such areas as buffer zones and emergency response training. It relies on its members to require or monitor compliance with its standards or guidelines.

24.99 A 1990 review of MIACC, conducted for the sponsoring federal government departments, concluded that, although it had set up a comprehensive action plan and provided an innovative forum, there were concerns about whether it would be effective in achieving its goals. A current major concern is whether industry is sufficiently committed to the process. Another assessment is planned for 1994.

Department of the Environment

24.100 In response to the risks outlined above, the Department of the Environment will receive, starting in fiscal year 1991–92, $25 million over a six–year period for its non–marine spills programs; and, as discussed below, it will also receive $23.8 million over a six–year period for marine spills.

24.101 Given its broad responsibilities for environmental emergencies, the Conservation and Protection Service of the Department recognized that it needed a program to deal with a wide range of environmental crises. Based on its experience with events such as the St. Basile chemical release and the Hagersville tire fire, it developed a "Crisis Management Planning Manual" and program. The Manual was approved in June 1991 by the Conservation and Protection Service management and is a good example of sound crisis management planning. If followed, it should enable the Department to readily move from day–to–day emergency operations to a departmental crisis management status.

24.102 The Department of the Environment recognizes that it does not yet have a complete inventory of hazardous installations and has not conducted

Since reporting to the Department of the Environment by industry is voluntary, it does not always receive immediate reports of significant spills of hazardous materials, especially those on industrial sites.

reviews of accident prevention activities at potentially hazardous installations. The Green Plan highlights the need for the inventory, and the Department plans to work with industry and the provinces to create it. The Department initiated work on the inventory in May 1992, and it expects to have it completed by mid–1993.

24.103 Since reporting to the Department by industry is voluntary, it does not always receive immediate reports of significant spills of hazardous materials, especially those on industrial sites. It obtains its information primarily from regional and provincial networks. It is now considering the need for regulations to significantly improve spill reporting and is working with the provinces and Major Industrial Accidents Council of Canada to strengthen existing arrangements.

24.104 The Department also recognizes that it does not have comprehensive information on chemical accidents. Its existing database is not adequate to provide the necessary information. Without comprehensive data on chemical accidents and spills, it will be difficult to measure the effectiveness of MIACC projects, the Department's hazardous–spill prevention/response program and other related federal programs.

24.105 The Canadian Chemical Producers' Association (CCPA) told us that, by 1993, it plans to establish a publicly available information system requiring member companies to report chemical emissions or spills into the air, land or water that are an environmental or health concern. According to the CCPA, the system will also require reporting of hazardous and non–hazardous waste disposal, by total tonnage. The CCPA plans to make these data part of the recently initiated Department of the Environment National Pollutant Release Inventory.

24.106 The Department acknowledges that it has limited information on "lessons learned" from industrial chemical spills or "near misses" that have occurred in Canada. The Bhopal Aftermath report indicated that obtaining this information is difficult since most of the best information is distributed only within the company having the accident, because of proprietary and liability concerns. The Department states that attempts through the Major Industrial Accidents Council of Canada at improving industry–government co–operation and breaking down barriers within industry have so far proven generally unsuccessful. The Council working group has decided to review major accidents only on an ad hoc basis with publicly available information.

24.107 Within the Conservation and Protection Service, the Preparedness Division of the Environmental Emergencies Branch is responsible for emergency planning, policies and standards for both marine and non–marine oil and chemical accidents. To help identify program building blocks, the Division conducted a survey in 1992 to identify the needs of its clients. The survey findings included the following:

- There is a need for clear policies, including the resolution of continuing federal–provincial jurisdictional questions.
- The Department of the Environment's national procedures for such areas as notification and incident reports need to be reviewed and updated.
- Specific emergency response standards need to be established, for example on clean–up.
- There is a need to establish realistic public expectations about responses and environmental damage; otherwise public and political expectations may adversely affect response activities.
- Many interdepartmental, intergovernmental, and government–industry agreements, protocols, and

plans exist, but most of these are out–of–date or forgotten; updating these agreements could be a major task.

- While the Department of the Environment has many response plans, the existing exercise program for these plans is inadequate.

24.108 In 1992–93 the Department plans to initiate projects to address these matters as well as those discussed earlier in the chapter.

Canadian Coast Guard

24.109 The Canada Shipping Act gives the Department of Transport the authority to remedy, minimize or prevent pollution damage originating from a ship.

24.110 The Canadian Coast Guard estimates that there are 3,500 spills annually in Canadian waters from all sources of oil and other hazardous substances. Two oil spills in rapid succession served to focus attention on the government's ability to deal with oil spills. On 23 December 1988, a tugboat collided with the tanker barge it was towing off Grays Harbour, Washington. Approximately 800 tonnes of "bunker C" heavy oil escaped. Early in January 1989, oil began washing ashore on Vancouver Island.

24.111 The tanker Exxon Valdez went aground in Prince William Sound, Alaska on 24 March 1989, spilling 40,000 tonnes of crude oil. Both events resulted in public concern about the ability of the government to respond to and manage such situations.

24.112 In spring of 1989, the federal government responded by initiating an internal review of the existing statutory and international regimes, and policies and systems to facilitate safe movement of tankers. The review also covered contingency planning and policies and capability for responding to spills from ships.

Public Review Panel on Tanker Safety and Marine Spills Response Capability

24.113 In June 1989, to allow for consultation with the general public and special interest groups, the government established a Public Review Panel on Tanker Safety and Marine Spills Response Capability (the Brander–Smith Panel). The Panel's report, dated September 1990, was highly critical of the current state of preparedness. Among its major findings were the following:

- The capability to respond effectively to a marine spill of any significant magnitude does not presently exist anywhere in Canada.
- Each year, based on current levels of tanker traffic, Canada can expect over 100 small spills (less than a tonne), about 10 moderate spills (about 100 tonnes), and at least one major spill (100 to 10,000 tonnes). A catastrophic spill (greater than 10,000 tonnes), for which we are totally unprepared, can be expected once every 15 years.
- About 70 percent of oil entering the marine environment is from routine incidents of negligence or intentional operational discharges.
- A major research and development effort is urgently needed to develop more effective spill clean–up equipment and technology, because what is now available is essentially primitive and largely ineffectual.
- Over 340 chemical spills occur in marine waters every year. The environmental and health hazards they pose are largely unknown and, in very rare circumstances where clean–up is possible, it costs on average 10 times as much, and takes 5 times as long, as oil spills.
- Canada is a signatory to an international agreement requiring inspection of 25 percent of all foreign vessels entering its ports. (Current

Based on current levels of tanker traffic, each year Canada can expect at least one major spill. A catastrophic spill can be expected once every 15 years.

A 1990 Public Review Panel concluded that the capability to respond effectively to a marine spill of any significant magnitude does not presently exist anywhere in Canada.

data from the Coast Guard indicate that 16 percent of foreign vessels were inspected in 1991, compared to 11 percent in 1989.)

- The Coast Guard's investigative and prosecution efforts are seriously inadequate and do little to deter polluters.
- The chances of polluters being caught are small, and of being caught and prosecuted even smaller.
- Although contingency plans exist, they are, for the most part, poorly designed, unco-ordinated and untested.

24.114 Government estimates in 1991 indicated that about $550 million — $408 million from the federal government and the remainder from the private sector — are required to implement all of the Brander-Smith Panel priority initiatives over a six-year period.

24.115 In October 1991, the Treasury Board approved an increase of $100 million over a six-year period for the Coast Guard, the Department of the Environment, and the Department of Fisheries and Oceans to implement a strategy that responded to key recommendations of the Panel. Of the $100 million, $3.9 million was allocated for policy development, $36 million for prevention, and $60 million for preparedness activities. About $63.5 million, $23.8 million and $12.7 million were given to Coast Guard, Environment and Fisheries and Oceans, respectively. Most of the initiatives are in the beginning stages or have not yet been started.

24.116 Cabinet directed that a detailed response to the Panel's recommendations be prepared by the end of 1991. As of mid-August 1992, the response had not yet been sent to Cabinet.

Department of the Environment's response: *Environment Canada recognized that to effectively deliver on its interdepartmental emergencies responsibilities, it needed to carefully co-ordinate its internal sector emergencies programs to provide a single departmental focus. Hence, effective April 1990, the responsibility for the co-ordination of departmental emergency and crisis preparedness was given to the Assistant Deputy Minister, Conservation and Protection. Since this action was taken, we are pleased to note we are now better co-ordinated internally and are discharging our interdepartmental responsibilities in a timely manner and that disputes are minimal.*

Environment Canada agrees with the need for the framework, as prepared by EPC, for a National Earthquake Support Plan. In addition to participating in the development of the NESP, Environment Canada has developed a Departmental Earthquake Support Plan for British Columbia, which primarily focusses on providing B.C. with support for an earthquake incident. This document is expected to be promulgated within the coming weeks.

The creation of MIACC is a significant development in co-operative efforts among stakeholders and signals a new way of working together, which is resulting in practical, effective and cost-efficient products. The partnership approach, from the perspective of Environment Canada, is the best means of preventing accidents and building preparedness in an area of fragmented jurisdiction.

Chapter 25

Background on the Audit Process

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Introduction

25.1 The preceding chapters of this Report describe the results of audit work and studies completed by the Office during the past year.

25.2 The purpose of this chapter is to provide some background on a few key features of the audit process, including what the Office considers when deciding what programs or activities will be audited. Information on the cost of audit work in Crown corporations is also included in paragraph 25.21 and Exhibit 25.2.

25.3 A description of the organization structure and other activities of the Office will be shown in its Part III of the Estimates for 1993–94. This Part III will be tabled in February 1993. A summary organization chart is contained in Exhibit 25.1.

Selecting an Area for Audit

25.4 A long–range audit plan is prepared for all departments, multi–departmental programs, and a number of functions that are common across government, such as internal audit and program evaluation. This plan normally covers a five–year period and identifies the proposed approach to completing the annual financial attest, compliance with authority, and value–for–money audit work required for a comprehensive audit of the entity.

25.5 The plan lays out a proposed cycle for audit work for each entity. These proposed cycles vary according to the nature of the entity, its level of expenditure and importance in government operations, and the resources available to carry out the audit. One department, for example, because of its size, may be on a 15–year cycle, while another can be covered in 5 to 9 years. A larger department may have more sophisticated control mechanisms, such as internal audit. Where these are functioning effectively, the need for the Office to audit various operations of the department on a more frequent cycle is reduced.

25.6 The Office's approach does not call for all operations of an entity to be audited within a particular audit cycle. The principles of audit worthiness and auditability are fundamental in deciding what to audit.

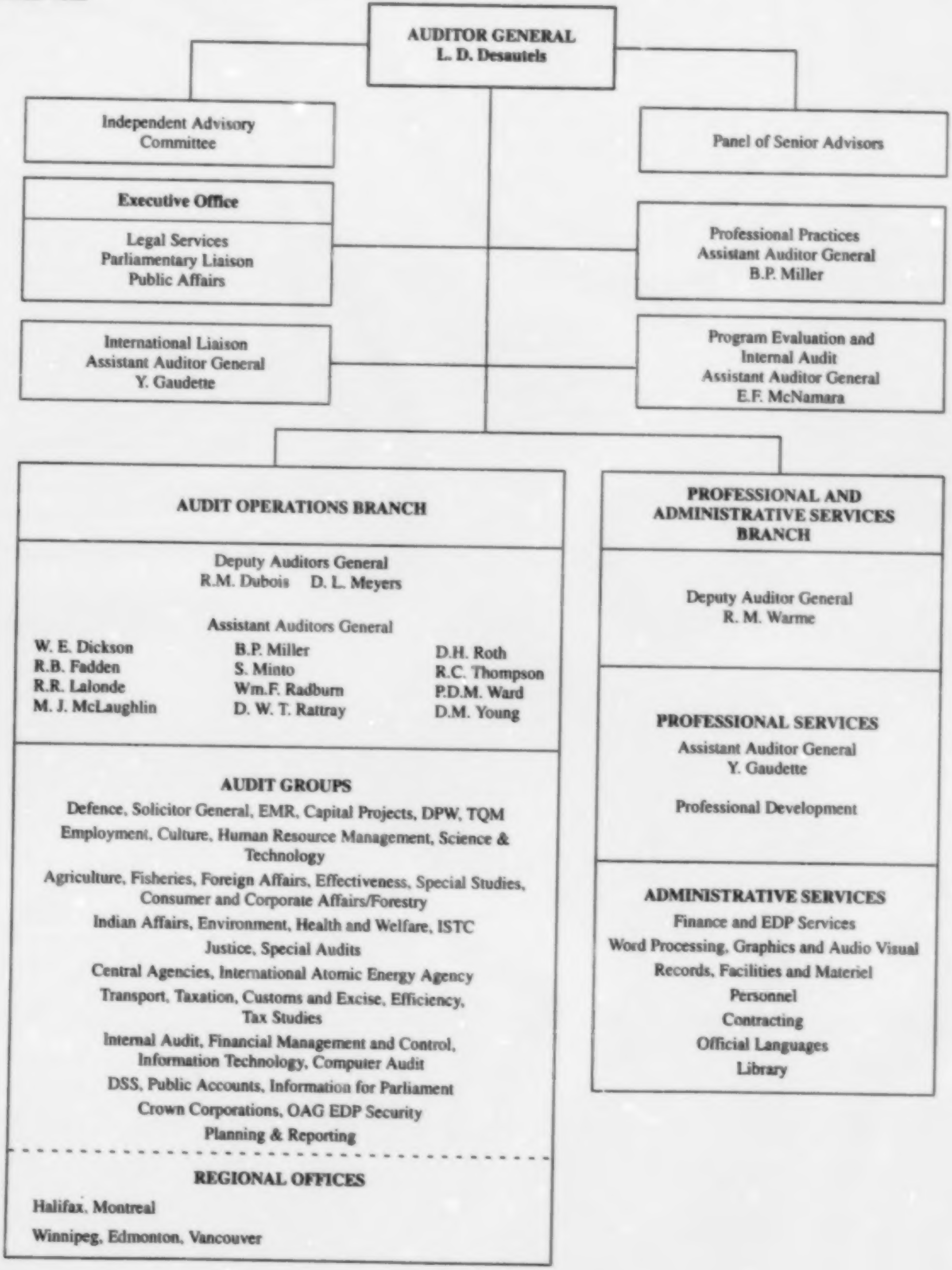
25.7 In assessing whether something is worth auditing, the Office looks at the significance of an entity or activity, including the social, economic, environmental, safety or equity impacts involved. Chapter 21 (National Revenue–Taxation: Resolving Disputes on Income Tax Assessments) deals with an area that is relatively small in terms of departmental expenditures, but is high in importance because it involves fair treatment of the taxpayer.

25.8 The risk factor is another important consideration in assessing audit worthiness. Some programs involve a high level of discretion in decisions on the eligibility of recipients and the amount of benefits received. The risk associated with this type of program tends to be higher. Payroll–related activities are basically routine and traditionally considered to be low–risk. However, the cash–out program described in Chapter 7 (Payments to Employees Under the Work Force Adjustment Policy) is an example of a payroll–related activity that is relatively high–risk from an audit perspective.

25.9 A further point when judging audit worthiness is sensitivity to the general political and managerial climate. Is the area under consideration the subject of current public debate? If it is, then the Office would determine whether an audit at the time could produce additional independent information to Parliament that would be of use to the debate. If not, the audit would probably be delayed. The Office must at all times remain — and be seen

Exhibit 25.1

Organization of the Office of the Auditor General
October 1992


AUDITOR GENERAL
L. D. Desautels
Independent Advisory Committee
Panel of Senior Advisors
Executive Office
Legal Services
Parliamentary Liaison
Public Affairs
Professional Practices
Assistant Auditor General
B.P. Miller
International Liaison
Assistant Auditor General
Y. Gaudette
Program Evaluation and Internal Audit
Assistant Auditor General
E.F. McNamara
AUDIT OPERATIONS BRANCH
Deputy Auditors General
R.M. Dubois D. L. Meyers
Assistant Auditors General
W. E. Dickson
R.B. Fadden
R.R. Lalonde
M. J. McLaughlin
B.P. Miller
S. Minto
Wm.F. Radburn
D. W. T. Rattray
D.H. Roth
R.C. Thompson
P.D.M. Ward
D.M. Young
AUDIT GROUPS
Defence, Solicitor General, EMR, Capital Projects, DPW, TQM
Employment, Culture, Human Resource Management, Science & Technology
Agriculture, Fisheries, Foreign Affairs, Effectiveness, Special Studies, Consumer and Corporate Affairs/Forestry
Indian Affairs, Environment, Health and Welfare, ISTC
Justice, Special Audits
Central Agencies, International Atomic Energy Agency
Transport, Taxation, Customs and Excise, Efficiency, Tax Studies
Internal Audit, Financial Management and Control, Information Technology, Computer Audit
DSS, Public Accounts, Information for Parliament
Crown Corporations, OAG EDP Security
Planning & Reporting
REGIONAL OFFICES
Halifax, Montreal
Winnipeg, Edmonton, Vancouver
PROFESSIONAL AND ADMINISTRATIVE SERVICES BRANCH
Deputy Auditor General
R. M. Warme
PROFESSIONAL SERVICES
Assistant Auditor General
Y. Gaudette
Professional Development
ADMINISTRATIVE SERVICES
Finance and EDP Services
Word Processing, Graphics and Audio Visual
Records, Facilities and Materiel
Personnel
Contracting
Official Languages
Library

to remain — independent and objective.

25.10 The second fundamental principle the Office must assess is auditability, or whether a particular audit is possible. This involves consideration of such questions as:

- Does the proposed area fall within the Office's audit mandate?
- Can the Office obtain sufficient evidence to reach an objective conclusion on the audit area?
- Can the Office assemble the expertise needed to carry out the audit successfully?
- Does the Office have the resources needed to conduct the audit in accordance with generally accepted auditing standards?

25.11 A proposed audit area must meet the tests of being both audit-worthy and auditable to be selected for audit.

Ensuring Audit Quality

25.12 Once an area has been selected for audit, the Office establishes an advisory committee to provide advice throughout the course of the audit. These committees usually have advisors from outside the Office and the Public Service, as well as from inside the Office.

25.13 External advisors have included former Members of Parliament and deputy ministers, business executives, academics, representatives of client groups, and recognized subject matter experts.

25.14 The purpose of these advisory committees is to provide advice and guidance on matters such as audit scope, criteria, methodology, the reasonableness of observations and recommendations, and the overall presentation of the report. In short, these committees guide, review and challenge the work of audit teams over the life of an audit.

25.15 For this year's Report, the Office used 56 outside advisors, including:

Exhibit 25.2

Costs of Preparing Annual Audit Reports for Fiscal Years Ending on or before 31 March 1992

Crown Corporation	Fiscal Year Ended	Cost Incurred
Atlantic Pilotage Authority	31.12.91	$ 51,470
Atomic Energy of Canada Limited	31.03.92	366,700
Canada Deposit Insurance Corporation	31.12.91	254,910
Canada Development Investment Corporation (Joint Auditor)	31.12.91	30,810
Canada Harbour Place Corporation	31.03.92	24,430
Canada Lands Company Limited	31.03.92	3,790
Canada Lands Company (Mirabel) Limited	31.03.92	10,290
Canada Lands Company (Vieux-Port de Québec) Inc.	31.03.92	8,660
Canada Mortgage and Housing Corporation (Joint Auditor)	31.12.91	258,910
Canada Museums Construction Corporation Inc.	31.03.92	44,010
Canada Post Corporation (Joint Auditor)	31.03.92	414,800
Canadian Commercial Corporation	31.03.92	69,120
Canadian Dairy Commission	31.07.91	151,790
Canadian Livestock Feed Board	31.03.92	28,200
Canadian Museum of Civilization	31.03.91	141,140
Canadian Museum of Civilization	31.03.92	111,670
Canadian Museum of Nature	31.03.91	69,920
Canadian Museum of Nature	31.03.92	66,610
Canadian National (West Indies) Steamships Limited	31.12.91	5,930
Canadian Patents and Development Limited	31.03.92	76,750
Canadian Saltfish Corporation	31.03.92	113,680
Cape Breton Development Corporation	31.03.92	211,960
Defence Construction (1951) Limited	31.03.92	48,360
Enterprise Cape Breton Corporation	31.03.92	118,470
Export Development Corporation	31.12.91	397,390
Farm Credit Corporation	31.03.92	282,280
Federal Business Development Bank (Joint Auditor)	31.03.92	228,270
Freshwater Fish Marketing Corporation	30.04.91	109,250
Great Lakes Pilotage Authority, Ltd.	31.12.91	37,570
Harbourfront Corporation (Joint Auditor)	31.03.92	27,140
International Centre for Ocean Development	31.03.92	76,510
Laurentian Pilotage Authority	31.12.91	96,140
Marine Atlantic Inc. (Joint Auditor)	31.12.91	142,800
National Capital Commission	31.03.92	282,320
National Gallery of Canada	31.03.91	149,890
National Gallery of Canada	31.03.92	97,560
National Museum of Science and Technology	31.03.91	61,260
National Museum of Science and Technology	31.03.92	57,770
Old Port of Montreal Corporation Inc.	31.03.92	109,080
Pacific Pilotage Authority	31.12.91	42,480
Royal Canadian Mint	31.12.91	213,100
The St. Lawrence Seaway Authority	31.03.92	78,970
Seaway International Bridge Corporation Ltd.	31.12.91	26,760
The Jacques Cartier and Champlain Bridges Incorporated	31.03.92	89,340
Standards Council of Canada	31.03.92	51,270
Teleglobe Canada	31.12.91	6,660
VIA Rail Canada Inc.	31.12.91	353,340

11 university professors
8 former deputy ministers and assistant deputy ministers in federal and provincial governments
7 former senior military officers in the regular forces and senior officers in the reserves
6 management consultants
5 current and former senior business executives
3 senior officials from an audit office outside Canada
3 engineers
3 lawyers
2 accountants
2 economists
1 former federal Cabinet minister
1 former member of Parliament
1 psychologist
1 research scientist
1 chief of police
1 current assistant deputy minister in the federal government

25.16 Observations, conclusions and recommendations are presented to entity management before an audit chapter is finalized. This permits the Office to obtain confirmation of audit facts and management reaction to the chapter. Management responses are included in the final draft. This process serves to highlight any areas of agreement or disagreement on any conclusions or recommendations emerging from an audit. It also permits the Public Accounts Committee to focus on the issues raised in a chapter.

25.17 This process is applied to all audits and reports to create an end product of the highest quality possible, in terms of both the way an audit is conducted and how it is reported.

Costs of Crown Corporation Audits

25.18 Section 147 of the Financial Administration Act (FAA) requires that the Office disclose the costs of preparing any audit report on a Crown corporation (see Exhibit 25.2). An audit report includes an opinion on a corporation's financial statements and on its compliance with specified authorities. It may also include reporting on any other matter deemed significant.

25.19 Section 138 of the FAA requires that at least once every five years, each parent Crown corporation named in Schedule III of the Act undergo a special examination. This is distinct from the requirement for the annual audit of financial statements.

25.20 The objective of a special examination is to determine whether a corporation's financial and management control and information systems and its management practices provide reasonable assurance that:

- assets have been safeguarded and controlled;
- financial, human and physical resources have been managed economically and efficiently; and
- operations have been carried out effectively.

25.21 In 1991–92 the Office completed the special examination of one Crown corporation, the Farm Credit Corporation, at a cost of $1,368,000. This includes an amount of $357,000 for costs incurred for preliminary examination work prior to a decision by the Corporation to delay the special examination.

Appendix A

Auditor General Act

R.S., c. A–17

An Act respecting the office of the Auditor General of Canada and matters related or incidental thereto

SHORT TITLE

Short title

1. This Act may be cited as the *Auditor General Act*. 1976–77, c. 34, s.1.

INTERPRETATION

Definitions

2. In this Act,

Auditor General

"Auditor General" means the Auditor General of Canada appointed pursuant to subsection 3(1);

Crown corporation

"Crown corporation" has the meaning assigned by section 83 of the *Financial Administration Act*;

Department

"department" has the meaning assigned to that term by section 2 of the *Financial Administration Act*;

Registrar

"registrar" means the Bank of Canada and a registrar appointed under Part IV of the *Financial Administration Act*. 1976–77, c. 34, s.2, 1984, c. 31, s.14.

AUDITOR GENERAL OF CANADA

Appointment and tenure of office

3. (1) The Governor in Council shall, by commission under the Great Seal, appoint a qualified auditor to be the officer called the Auditor General of Canada to hold office during good behaviour for a term of ten years, but the Auditor General may be removed by the Governor in Council on address of the Senate and House of Commons.

Idem

(2) Notwithstanding subsection (1), the Auditor General ceases to hold office on attaining the age of sixty–five years.

Re–appointment

(3) Once having served as the Auditor General, a person is not eligible for re–appointment to that office.

Vacancy

(4) In the event of the absence or incapacity of the Auditor General or if the office of Auditor General is vacant, the Governor in Council may appoint a person temporarily to perform the duties of Auditor General. 1976–77, c. 34, s.3.

Salary

4. (1) The Auditor General shall be paid a salary equal to the salary of a puisne judge of the Supreme Court of Canada.

Pension benefits

(2) The provisions of the *Public Service Superannuation Act*, other than those relating to tenure of office, apply to the Auditor General except that a person appointed as Auditor General from outside the Public Service may, by notice in writing given to the President of the Treasury Board not more than sixty days after the date of his appointment as Auditor General, elect to participate in the pension plan provided for in the *Diplomatic Service (Special)*

Superannuation Act in which case the provisions of that Act, other than those relating to tenure of office, apply to him and the provisions of the *Public Service Superannuation Act* do not apply to him. 1976–77, c. 34, s.4; 1980–81–82–83, c. 50 s.23, c. 55, s.1.

DUTIES

Examination

5. The Auditor General is the auditor of the accounts of Canada, including those relating to the Consolidated Revenue Fund and as such shall make such examinations and inquiries as he considers necessary to enable him to report as required by this Act. 1976–77, c. 34, s.5.

Idem

6. The Auditor General shall examine the several financial statements required by section 64 of the *Financial Administration Act* to be included in the Public Accounts, and any other statement that the President of the Treasury Board or the Minister of Finance may present for audit and shall express his opinion as to whether they present fairly information in accordance with stated accounting policies of the federal government and on a basis consistent with that of the preceding year together with any reservations he may have. 1976–77, c. 34, s. 6; 1980–81–82–83, c. 170, s. 25.

Report to House of Commons

7. (1) The Auditor General shall report annually to the House of Commons

(a) on the work of his office; and,

(b) on whether, in carrying on the work of his office, he received all the information and explanations he required.

Idem

(2) Each report of the Auditor General under subsection (1) shall call attention to anything that he considers to be of significance and of a nature that should be brought to the attention of the House of Commons, including any cases in which he has observed that

(a) accounts have not been faithfully and properly maintained or public money has not been fully accounted for or paid, where so required by law, into the Consolidated Revenue Fund;

(b) essential records have not been maintained or the rules and procedures applied have been insufficient to safeguard and control public property, to secure an effective check on the assessment, collection and proper allocation of the revenue and to ensure that expenditures have been made only as authorized;

(c) money has been expended other than for purposes for which it was appropriated by Parliament;

(d) money has been expended without due regard to economy or efficiency; or

(e) satisfactory procedures have not been established to measure and report the effectiveness of programs, where such procedures could appropriately and reasonably be implemented.

Submission of report to Speaker and tabling in the House of Commons

(3) Each annual report by the Auditor General to the House of Commons shall be submitted to the Speaker of the House of Commons on or before the 31st day of December in the year to which the report relates and the Speaker of the House of Commons shall lay each such report before the House of Commons forthwith after receipt thereof by him or, if that House is not then sitting, on the first day next thereafter that the House of Commons is sitting. 1976–77, c. 34, s.7.

Special report

8. (1) The Auditor General may make a special report to the House of Commons on any matter of pressing importance or urgency that, in his opinion, should not be deferred until the presentation of his annual report.

Submission of reports to Speaker and tabling in the House of Commons

(2) Each special report of the Auditor General to the House of Commons made under subsection (1) or 19(2) shall be submitted to the Speaker of the House of Commons and shall be laid before the House of Commons by the Speaker of the House of Commons forthwith after receipt thereof by him, or if that House is not then sitting, on the first day next thereafter that the House of Commons is sitting. 1976–77, c. 34, s.8.

Idem

9. The Auditor General shall

(a) make such examination of the accounts and records of each registrar as he deems necessary, and such other examinations of a registrar's transactions as the Minister of Finance may require, and;

(b) when and to the extent required by the Minister of Finance, participate in the destruction of any redeemed or cancelled securities or unissued reserves of securities authorized to be destroyed under the *Financial Administration Act*;

and he may, by arrangement with a registrar, maintain custody and control, jointly with that registrar, of cancelled and unissued securities. 1976–77, c. 34, s.9.

Improper retention of public money

10. Whenever it appears to the Auditor General that any public money has been improperly retained by any person, he shall forthwith report the circumstances of the case to the President of the Treasury Board. 1976–77, c. 34, s.10.

Inquiry and report

11. The Auditor General may, if in his opinion such an assignment does not interfere with his primary responsibilities, whenever the Governor in Council so requests, inquire into and report on any matter relating to the financial affairs of Canada or to public property or inquire into and report on any person or organization that has received financial aid from the Government of Canada or in respect of which financial aid from the Government of Canada is sought. 1976–77, c. 34, s.11.

Advisory powers

12. The Auditor General may advise appropriate officers and employees in the public service of Canada of matters discovered in his examinations and, in particular, may draw any such matter to the attention of officers and employees engaged in the conduct of the business of the Treasury Board. 1976–77, c. 34, s.12.

ACCESS TO INFORMATION

Access to information

13. (1) Except as provided by any other Act of Parliament that expressly refers to this subsection, the Auditor General is entitled to free access at all convenient times to information that relates to the fulfilment of his responsibilities and he is also entitled to require and receive from members of the public service of Canada such information, reports and explanations as he deems necessary for that purpose.

Stationing of officers in departments

(2) In order to carry out his duties more effectively, the Auditor General may station in any department any person employed in his office, and the department shall provide the necessary office accommodation for any person so stationed.

Oath of secrecy

(3) The Auditor General shall require every person employed in his office who is to examine the accounts of a department or of a Crown corporation pursuant to this Act to comply with any security requirements applicable to, and to take any oath of secrecy required to be taken by, persons employed in that department or Crown corporation.

Inquiries

(4) The Auditor General may examine any person on oath on any matter pertaining to any account subject to audit by him and for the purposes of any such examination the Auditor General may exercise all the powers of a commissioner under Part I of the *Inquiries Act*. 1976–77, c. 34, s.13.

Reliance on audit reports of Crown corporations

14. (1) Notwithstanding subsections (2) and (3), in order to fulfil his responsibilities as the auditor of the accounts of Canada, the Auditor General may rely on the report of the duly appointed auditor of a Crown corporation or of any subsidiary of a Crown corporation.

Auditor General may request information

(2) The Auditor General may request a Crown corporation to obtain and furnish to him such information and explanations from its present or former directors, officers, employees, agents and auditors or those of any of its subsidiaries as are, in his opinion, necessary to enable him to fulfil his responsibilities as the auditor of the accounts of Canada.

Direction of the Governor in Council

(3) If, in the opinion of the Auditor General, a Crown corporation, in response to a request made under subsection (2), fails to provide any or sufficient information or explanations, he may so advise the Governor in Council, who may thereupon direct the officers of the corporation to furnish the Auditor General with such information and explanations and to give him access to those records, documents, books, accounts and vouchers of the corporation or any of its subsidiaries access to which is, in the opinion of the Auditor General, necessary for him to fulfil his responsibilities as the auditor of the accounts of Canada. 1976–77, c. 34, s.14.

STAFF OF THE AUDITOR GENERAL

Officers, etc.

15. (1) Such officers and employees as are necessary to enable the Auditor General to perform his duties shall be appointed in accordance with the *Public Service Employment Act*.

Contract for professional services

(2) Subject to any other Act of Parliament or regulations made thereunder, but without the approval of the Treasury Board, the Auditor General may, within the total dollar limitations established for his office in appropriation Acts, contract for professional services.

Delegation to Auditor General

(3) The Auditor General may exercise and perform, in such manner and subject to such terms and conditions as the Public Service Commission directs, the powers, duties and functions of the Public Service Commission under the *Public Service Employment Act*, other than the powers, duties and functions of the Commission in relation to appeals under sections 21 and 31 of that Act and inquiries under section 34 of that Act

Suspension

(4) The Auditor General may suspend from the performance of his duty any person employed in his office. 1976–77, c. 34, s.15.

Responsibility for personnel management

16. In respect of persons employed in his office, the Auditor General is authorized to exercise the powers and perform the duties and functions of the Treasury Board under the *Financial Administration Act* that relate to personnel management including the determination of terms and conditions of employment and the responsibility for employer and employee relations, within the meaning of paragraph (1)(e) and sections 11 to 13 of that Act. 1976–77, c. 34, s.16.

Classification standards

17. Classification standards may be prepared for persons employed in the office of the Auditor General to conform with the classifications that the Auditor General recognizes for the purposes of that office. 1976–77, c. 34, s.18.

Delegation

18. The Auditor General may designate a senior member of his staff to sign on his behalf any opinion that he is required to give and any report, other than his annual report on the financial statements of Canada made pursuant to section 64 of the *Financial Administration Act* and his reports to the House of Commons under this Act and any member so signing an opinion or report shall indicate beneath his signature his position in the office of the Auditor General and the fact that he is signing on behalf of the Auditor General. 1976–77, c. 34, s.19.

ESTIMATES

Estimates

19. (1) The Auditor General shall annually prepare an estimate of the sums that will be required to be provided by Parliament for the payment of the salaries, allowances and expenses of his office during the next ensuing fiscal year.

Special report

(2) The Auditor General may make a special report to the House of Commons in the event that amounts provided for his office in the estimates submitted to Parliament are, in his opinion, inadequate to enable him to fulfil the responsibilities of his office. 1976–77, c. 34, s.20.

Appropriation allotments

20. The provisions of the *Financial Administration Act* with respect to the division of appropriations into allotments do not apply in respect of appropriations for the office of the Auditor General. 1976–77, c. 34, s.21.

AUDIT OF THE OFFICE OF THE AUDITOR GENERAL

Audit of the office of the Auditor General

21. (1) A qualified auditor nominated by the Treasury Board shall examine the receipts and disbursements of the office of the Auditor General and shall report annually the outcome of his examinations to the House of Commons.

Submission of reports and tabling

(2) Each report referred to in subsection (1) shall be submitted to the President of the Treasury Board on or before the 31st day of December in the year to which the report relates and the President of the Treasury Board shall lay each such report before the House of Commons within fifteen days after receipt thereof by him or, if that House is not then sitting, on any of the first fifteen days next thereafter that the House of Commons is sitting. 1976–77, c. 34, s.22.

Appendix B

Financial Administration Act

Extracts from Part X

FINANCIAL ADMINISTRATION ACT

R.S., c. F–11

Extracts from Part X

CROWN CORPORATIONS

Financial Management

Books and systems

131. (1) Each parent Crown corporation shall cause

(a) books of account and records in relation thereto to be kept, and

(b) financial and management control and information systems and management practices to be maintained,

in respect of itself and each of its wholly–owned subsidiaries, if any.

Idem

(2) The books, records, systems and practices referred to in subsection (1) shall be kept and maintained in such manner as will provide reasonable assurance that

(a) the assets of the corporation and each subsidiary are safeguarded and controlled;

(b) the transactions of the corporation and each subsidiary are in accordance with this Part, the regulations, the charter and by–laws of the corporation or subsidiary and any directive given to the corporation; and

(c) the financial, human and physical resources of the corporation and each subsidiary are managed economically and efficiently and the operations of the corporation and each subsidiary are carried out effectively.

Internal audit

(3) Each parent Crown corporation shall cause internal audits to be conducted, in respect of itself and each of its wholly–owned subsidiaries, if any, to assess compliance with subsections (1) and (2), unless the Governor in Council is of the opinion that the benefits to be derived from those audits do not justify their cost.

Financial statements

(4) Each parent Crown corporation shall cause financial statements to be prepared annually, in respect of itself and its wholly–owned subsidiaries, if any, in accordance with generally accepted accounting principles as supplemented or augmented by regulations made pursuant to subsection (6) if any.

Form of financial statements

(5) The financial statements of a parent Crown corporation and of a wholly–owned subsidiary shall be prepared in a form that clearly sets out information according to the major businesses or activities of the corporation or subsidiary.

Regulations

(6) The Treasury Board may, for the purposes of subsection (4), make regulations respecting financial statements either generally or in respect of any specified parent Crown corporation or any parent Crown corporation of a specified class, but such regulations shall, in

respect of the preparation of financial statements, only supplement or augment generally accepted accounting principles. 1991, c. 24, s. 41.

Auditor's Reports

Annual auditor's report

132. (1) Each parent Crown corporation shall cause an annual auditor's report to be prepared, in respect of itself and its wholly–owned subsidiaries, if any, in accordance with the regulations, on

(a) the financial statements referred to in section 131 and any revised financial statement referred to in subsection 133(3); and

(b) any quantitative information required to be audited pursuant to subsection (5).

Contents

(2) A report under subsection (1) shall be addressed to the appropriate Minister and shall

(a) include separate statements, whether in the auditor's opinion,

(i) the financial statements are presented fairly in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year,

(ii) the quantitative information is accurate in all material respects and, if applicable, was prepared on a basis consistent with that of the preceding year, and

(iii) the transactions of the corporation and of each subsidiary that have come to his notice in the course of the auditor's examination for the report were in accordance with this Part, the regulations, the charter and by–laws of the corporation or subsidiary and any directive given to the corporation; and

(b) call attention to any other matter falling within the scope of the auditor's examination for the report that, in his opinion, should be brought to the attention of Parliament.

Regulations

(3) The Treasury Board may make regulations prescribing the form and manner in which the report referred to in subsection (1) is to be prepared.

Separate reports

(4) Notwithstanding any other provision of this Part, the auditor of a parent Crown corporation may prepare separate annual auditor's reports on the statements referred to in paragraph (1)(a) and on the information referred to in paragraph (1)(b) if, in the auditor's opinion, separate reports would be more appropriate.

Audit of quantitative information

(5) The Treasury Board may require that any quantitative information required to be included in a parent Crown corporation's annual report pursuant to subsection 150(3) be audited.

Other reports

(6) The auditor of a parent Crown corporation shall prepare such other reports respecting the corporation or any wholly–owned subsidiary of the corporation as the Governor in Council may require.

Examination

(7) An auditor shall make such examination as he considers necessary to enable him to prepare a report under subsection (1) or (6).

Reliance on internal audit

(8) An auditor shall, to the extent he considers practicable, rely on any internal audit of the corporation being audited that is conducted pursuant to subsection 131(3). 1991, c. 24, s. 42.

Errors and omissions

133. (1) A director or officer of a Crown corporation shall forthwith notify the auditor and the audit committee of the corporation, if any, of any error or omission of which the director or officer becomes aware in a financial statement that the auditor or a former auditor has reported on or in a report prepared by the auditor or a former auditor pursuant to section 132.

Idem

(2) Where an auditor or former auditor of a Crown corporation is notified or becomes aware of any error or omission in a financial statement that the auditor or former auditor has reported on or in a report prepared by the auditor or former auditor pursuant to section 132, he shall forthwith notify each director of the corporation of the error or omission if he is of the opinion that the error or omission is material.

Correction

(3) Where an auditor or former auditor of a Crown corporation notifies the directors of an error or omission in a financial statement or report pursuant to subsection (2), the corporation shall prepare a revised financial statement or the auditor or former auditor shall issue a correction to the report, as the case may be, and a copy thereof shall be given to the appropriate Minister. 1984, c. 31, s. 11.

Auditors

Appointment of auditor

134. (1) The auditor of a parent Crown corporation shall be appointed annually by the Governor in Council, after the appropriate Minister has consulted the board of directors of the corporation, and may be removed at any time by the Governor in Council, after the appropriate Minister has consulted the board.

Auditor General

(2) On and after January 1, 1989, the Auditor General of Canada shall be appointed by the Governor in Council as the auditor, or a joint auditor, of each parent Crown corporation named in Part I of Schedule III, unless the Auditor General waives the requirement that he be so appointed.

Idem

(3) Subsections (1) and (2) do not apply in respect of any parent Crown corporation the auditor of which is specified by any other Act of Parliament to be the Auditor General of Canada, but the Auditor General is eligible to be appointed the auditor, or a joint auditor, of a parent Crown corporation pursuant to subsection (1) and section 135 does not apply to him.

Exception

(4) Notwithstanding subsection (1), where the report referred to in subsection 132(1) is to be prepared in respect of a wholly–owned subsidiary separately, the board of directors of the parent Crown corporation that wholly owns the subsidiary shall, after consultation with the board of directors of the subsidiary, appoint the auditor of the subsidiary, and subsections (6) and sections 135 to 137 apply in respect of that auditor as though the references therein to a parent Crown corporation were references to the subsidiary.

Criteria for appointment

(5) The Governor in Council may make regulations prescribing the criteria to be applied in selecting an auditor for appointment pursuant to subsection (1) or (4).

Re–appointment

(6) An auditor of a parent Crown corporation is eligible for re–appointment on the expiration of his appointment.

Continuation in office

(7) Notwithstanding subsection (1), if an auditor of a parent Crown corporation is not appointed to take office on the expiration of the appointment of an incumbent auditor, the incumbent auditor continues in office until his successor is appointed. 1984, c.31, s.11.

Persons not eligible

135. (1) A person is disqualified from being appointed or re–appointed or continuing as an auditor of a parent Crown corporation pursuant to section 134 if that person is not independent of the corporation, any of its affiliates, or the directors or officers of the corporation or any of its affiliates.

Independence

(2) For the purpose of this section,

(a) independence is a question of fact; and

(b) a person is deemed not to be independent if that person or any of his business partners

(i) is a business partner, director, officer or employee of the parent Crown corporation or any of its affiliates, or a business partner of any director, officer or employee of the corporation or any of its affiliates,

(ii) beneficially owns or controls, directly or indirectly through a trustee, legal representative, agent or other intermediary, a material interest in the shares or debt of the parent Crown corporation or any of its affiliates, or

(iii) has been a receiver, receiver–manager, liquidator or trustee in bankruptcy of the parent Crown corporation or any of its affiliates within two years of his proposed appointment as auditor of the corporation.

Resignation

(3) An auditor of a parent Crown corporation who becomes disqualified under this section shall resign forthwith after becoming aware of his disqualification. 1984, c.31, s.11.

Qualifications preserved

136. Nothing in sections 134 and 135 shall be construed as empowering the appointment, re–appointment or continuation in office as an auditor of a parent Crown corporation of any person who does not meet any qualifications for such appointment, re–appointment or continuation established by any other Act of Parliament. 1984, c. 31, s. 11.

Resignation

137. A resignation of an auditor of a parent Crown corporation becomes effective at the time the corporation receives a written resignation from the auditor or at the time specified in the resignation, whichever is later. 1984, c. 31, s. 11.

Special Examination

Special examination

138. (1) Each parent Crown corporation shall cause a special examination to be carried out in respect of itself and its wholly–owned subsidiaries, if any, to determine if the systems and practices referred to in paragraph 131(1)(b) were, in the period under examination, maintained in a manner that provided reasonable assurance that they met the requirements of paragraphs 131(2)(a) and (c).

Time for examination

(2) A special examination shall be carried out at least once every five years and at such additional times as the Governor in Council, the appropriate Minister or the board of directors of the corporation to be examined may require.

Plan

(3) Before an examiner commences a special examination, he shall survey the systems and practices of the corporation to be examined and submit a plan for the examination, including a statement of the criteria to be applied in the examination, to the audit committee of the corporation, or if there is no audit committee, to the board of directors of the corporation.

Resolution of disagreements

(4) Any disagreement between the examiner and the audit committee or board of directors of a corporation with respect to a plan referred to in subsection (3) may be resolved

(a) in the case of a parent Crown corporation, by the appropriate Minister; and

(b) in the case of a wholly–owned subsidiary, by the parent Crown corporation that wholly owns the subsidiary.

Reliance on internal audit

(5) An examiner shall, to the extent he considers practicable, rely on any internal audit of the corporation being examined conducted pursuant to subsection 131(3). 1984, c.31, s.11.

Report

139. (1) An examiner shall, on completion of the special examination, submit a report on his findings to the board of directors of the corporation examined.

Contents

(2) The report of an examiner under subsection (1) shall include

(a) a statement, whether in the examiner's opinion, with respect to the criteria established pursuant to subsection 138(3), there is reasonable assurance that there are no significant deficiencies in the systems and practices examined; and

(b) a statement of the extent to which the examiner relied on internal audits. 1984, c.31, s.11.

Special report of appropriate Minister

140. Where the examiner of a parent Crown corporation, or a wholly owned subsidiary of a parent Crown corporation, named in Part I of Schedule III is of the opinion that his report under subsection 139(1) contains information that should be brought to the attention of the appropriate Minister, he shall, after consultation with the board of directors of the corporation, or with the board of the subsidiary and corporation, as the case may be, report that information to the Minister and furnish the board or boards with a copy of the report. 1984, c.31, s.11.

Special report to Parliament

141. Where the examiner of a parent Crown corporation, or a wholly–owned subsidiary of a parent Crown corporation, named in Part I of Schedule III of the opinion that his report under subsection 139(1) contains information that should be brought to the attention of Parliament, he shall, after consultation with the appropriate Minister and the board of directors of the corporation, or with the boards of the subsidiary and corporation, as the case may be, prepare a report thereon for inclusion in the next annual report of the corporation and furnish the board or boards, the appropriate Minister and the Auditor General of Canada with copies of the report. 1984, c.31, s.11.

Examiner

142. (1) Subject to subsections (2) and (3), a special examination referred to in section 138 shall be carried out by the auditor of a parent Crown corporation.

Idem

(2) Where, in the opinion of the Governor in Council, a person other than the auditor of a parent Crown corporation should carry out a special examination, the Governor in Council may, after the appropriate Minister has consulted the board of directors of the corporation, appoint an auditor who is qualified for the purpose to carry out the examination in lieu of the

auditor of the corporation and may, after the appropriate Minister has consulted the board, remove that qualified auditor at any time.

Exception

(3) Where a special examination is to be carried out in respect of a wholly–owned subsidiary separately, the board of directors of the parent Crown corporation that wholly owns the subsidiary shall, after consultation with the board of directors of the subsidiary, appoint the qualified auditor who is to carry out the special examination.

Applicable provisions

(4) Subject to subsection (5), sections 135 and 137 apply in respect of an examiner as though the references therein to an auditor were references to an examiner.

Auditor General eligible

(5) The Auditor General of Canada is eligible to be appointed an examiner and section 135 does not apply to the Auditor General of Canada in respect of such an appointment. 1984, c. 31, s. 11.

Consultation with Auditor General

Consultation with Auditor General

143. The auditor or examiner of a Crown corporation may at any time consult the Auditor General of Canada on any matter relating to his audit or special examination and shall consult the Auditor General with respect to any matter that, in the opinion of the auditor or examiner, should be brought to the attention of Parliament pursuant to paragraph 132(2)(b) or section 141. 1984, c. 31, s. 11.

Right to Information

Right to information

144. (1) On the demand of the auditor or examiner of a Crown corporation, the present or former directors, officers, employees or agents of the corporation shall furnish such

(a) information and explanations, and

(b) access to records, documents, books, accounts and vouchers of the corporation or any of its subsidiaries

as the auditor or examiner considers necessary to enable him to prepare any report as required by this Division and that the directors, officers, employees or agents are reasonably able to furnish.

Idem

(2) On the demand of the auditor or examiner a Crown corporation, the directors of the corporation shall

(a) obtain from the present or former directors, officers, employees or agents of any subsidiary of the corporation such information and explanations as the auditor or examiner considers necessary to enable him to prepare any report as required by this Division and that the present or former directors, officers, employees or agents are reasonably able to furnish; and

(b) furnish the auditor or examiner with the information and explanations so obtained.

Reliance on reports

(3) An auditor or examiner of a Crown corporation may reasonably rely on any report of any other auditor or examiner. 1984, c. 31, s. 11.

Policy

Restriction

145. Nothing in this Part or the regulations shall be construed as authorizing the auditor or examiner of a Crown corporation to express any opinion on the merits of matters of policy, including the merits of

(a) the objects or purposes for which the corporation is incorporated, or the restrictions on the businesses or activities that it may carry on, as set out in its charter;

(b) the objectives of the corporation; and

(c) any business or policy decision of the corporation or of the Government of Canada. 1984, c. 31, s. 11.

Qualified Privilege

Qualified privilege

146. Any oral or written statement or report made under this Part or the regulations by the auditor or a former auditor, or the examiner or a former examiner, of a parent Crown corporation or a wholly–owned subsidiary has qualified privilege. 1991, c. 24, s. 43.

Costs

Cost of audit and examination

147. (1) The amounts paid to an auditor or examiner of a Crown corporation for preparing any report under section 132, 139, 140 or 141 shall be reported to the President of the Treasury Board.

Idem

(2) Where the Auditor General of Canada is the auditor or examiner of a Crown corporation, the costs incurred by him in preparing any report under section 132, 139, 140 or 141 shall be disclosed in the next annual report of the Auditor General and be paid out of the moneys appropriated for his office. 1984, c. 31, s. 11.

Audit Committee

Audit committee

148. (1) Each parent Crown corporation that has four or more directors shall establish an audit committee composed of not less than three directors of the corporation, the majority of whom are not officers or employees of the corporation or any of its affiliates.

Idem

(2) In the case of a parent Crown corporation that has less than four directors, the board of directors of the corporation constitutes the audit committee of the corporation and shall perform the duties and functions assigned to an audit committee by any provision of this Part and the provision shall be construed accordingly.

Duties

(3) The audit committee of a parent Crown corporation shall

(a) review, and advise the board of directors with respect to, the financial statements that are to be included in the annual report of the corporation;

(b) oversee any internal audit of the corporation that is conducted pursuant to subsection 131(3);

(c) review, and advise the board of directors with respect to, the annual auditor's report of the corporation referred to in subsection 132(1);

(d) in the case of a corporation undergoing a special examination, review, and advise the board of directors with respect to, the plan and reports referred to in sections 138 to 141; and

(e) perform such other functions as are assigned to it by the board of directors or the charter or by–laws of the corporation.

Auditor's or examiner's attendance

(4) The auditor and any examiner of a parent Crown corporation are entitled to receive notice of every meeting of the audit committee and, at the expense of the corporation, to attend and be heard at each meeting; and, if so requested by a member of the audit committee, the auditor or examiner shall attend any or every meeting of the committee held during his term of office.

Calling meeting

(5) The auditor or examiner of a parent Crown corporation or a member of the audit committee may call a meeting of the committee.

Wholly–owned subsidiary

(6) Where the report referred to in subsection 132(1) is to be prepared in respect of a wholly–owned subsidiary separately, subsections (1) to (5) apply, with such modifications as the circumstances require, in respect of the subsidiary as though

(a) the references in subsections (1) to (5) to a parent Crown corporation were references to the subsidiary; and

(b) the reference in paragraph (3)(a) to the annual report of the corporation were a reference to the annual report of the parent Crown corporation that wholly owns the subsidiary. 1984, c. 31, s. 11.

Reports

Accounts, etc. to Treasury Board or appropriate Minister

149. (1) A parent Crown corporation shall provide the Treasury Board or the appropriate Minister with such accounts, budgets, returns, statements, documents, records, books, reports or other information as the Board or appropriate Minister may require.

Reports on material developments

(2) The chief executive officer of a parent Crown corporation shall, as soon as reasonably practicable, notify the appropriate Minister, the President of the Treasury Board and any director of the corporation not already aware thereof of any financial or other developments that, in the chief executive officer's opinion, are likely to have a material effect on the performance of the corporation, including its wholly–owned subsidiaries, if any, relative to the corporation's objectives or on the corporation's requirements for funding.

Reports on wholly–owned subsidiaries

(3) Each parent Crown corporation shall forthwith notify the appropriate Minister and the President of the Treasury Board of the name of any corporation that becomes or ceases to be a wholly–owned subsidiary of the corporation. 1984, c. 31, s. 11.

Annual report

150. (1) Each parent Crown corporation shall, as soon as possible, but in any case within three months, after the termination of each financial year submit an annual report on the operations of the corporation in that year concurrently to the appropriate Minister and the President of the Treasury Board, and the appropriate Minister shall cause a copy of the report to be laid before each House of Parliament on any of the first fifteen days on which that House is sitting after he receives it.

Reference to committee

(2) An annual report laid before Parliament pursuant to subsection (1) stands permanently referred to such committee of Parliament as may be designated or established to review matters relating to the businesses and activities of the corporation submitting the report.

Form and contents

(3) The annual report of a parent Crown corporation shall include

(a) the financial statements of the corporation referred to in section 131,

(b) the annual auditor's report referred to in subsection 132(1),

(c) a statement on the extent to which the corporation has met its objectives for the financial year,

(d) such quantitative information respecting the performance of the corporation, including its wholly–owned subsidiaries, if any, relative to the corporation's objectives as the Treasury Board may require to be included in the annual report, and

(e) such other information as is required by this or any other Act of Parliament, or by the appropriate Minister, the President of the Treasury Board or the Minister of Finance, to be included in the annual report,

and shall be prepared in a form that clearly sets out information according to the major businesses or activities of the corporation and its wholly–owned subsidiaries, if any.

Idem

(4) In addition to any other requirements under this Act or any other Act of Parliament, the Treasury Board may, by regulation, prescribe the information to be included in annual reports and the form in which such information is to be prepared. 1991, c. 24, s. 49.

Annual consolidated report

151. (1) The President of the Treasury Board shall, not later than December 31 of each year, cause a copy of an annual consolidated report on the businesses and activities of all parent Crown corporations for their financial years ending on or before the previous July 31 to be laid before each House of Parliament.

Reference to committee

(2) An annual consolidated report laid before Parliament pursuant to subsection (1) stands permanently referred to such committee of Parliament as may be designated or established to review matters relating to Crown corporations.

Contents

(3) The annual consolidated report referred to in subsection (1) shall include

(a) a list naming, as of a specified date, all Crown corporations and all corporations of which any shares are held by, on behalf of or in trust for the Crown or any Crown corporation;

(b) employment and financial data, including aggregate borrowings of parent Crown corporations; and

(c) such other information as the President of the Treasury Board may determine. 1984, c. 31, s. 11.

Annual report

152. (1) The President of the Treasury Board shall, not later than December 31 of each year, cause to be laid before each House of Parliament a copy of a report indicating the

summaries and annual reports that under this Part were to be laid before that House by July 31 in that year, the time at, before or within which they were to be laid and the time they were laid before that House.

Attest (2) The accuracy of the information contained in the report referred to in subsection (1) shall be attested by the Auditor General of Canada in the Auditor General's report to the House of Commons. 1991, c. 24, s. 44.

Appendix C

Reports of the Standing Committee on Public Accounts to the House of Commons

REPORT TO THE HOUSE

Thursday, June 6, 1991

The Standing Committee on Public Accounts has the honour to present its

FIRST REPORT

In accordance with the Order of Reference of Friday, May 17, 1991, your Committee has considered Vote 20 under FINANCE in the Main Estimates for the fiscal year ending March 31, 1992, and reports the same.

A copy of the relevant *Minutes of Proceedings and Evidence (Issue No. 1, which includes this Report)* is tabled.

Respectfully submitted,

JEAN–ROBERT GAUTHIER

Chairman.

REPORT TO THE HOUSE

Friday, November 1, 1991

The Standing Committee on Public Accounts has the honour to present its

SECOND REPORT

Pursuant to Standing Order 108(3)(e), your Committee examined the disbandment of the Department of Finance's Tax Evaluation Division in light of Chapter 3 of the Auditor General's 1983 Report—Program Evaluation.

Whoever wishes to optimize resource use must be accurately informed about the way programs perform. Program evaluation makes it possible to know whether the *raison d'être*, goals, anticipated and actual results and program design are satisfactory. When such evaluations, measuring program performance and effectiveness, are made public, they increase the accountability of the government and its officials and stimulate debate in both the parliamentary and the public forum.

Program evaluation is all the more important in the current context of budgetary restraint, since resource optimization is now obligatory. The government must continually improve the allocation of ever–scarcer resources. In this constrictive climate, evaluating tax measures takes on even greater significance, since the effectiveness of the country's fiscal policies must be under constant review and the fairness of the various tax measures affecting Canadians must be re–examined on an on–going basis.

The Committee was therefore surprised to learn that the Department of Finance was disbanding its Tax Evaluation Division. Notice of the reorganization of this important evaluation unit came solely in the form of an internal memo, even though the Division had been created in 1987 in response to numerous recommendations by the Auditor General, the House of Commons Public Accounts Committee and the Senate Committee on National Finance, and even though the Minister of Finance at the time and his senior managers had spoken glowingly of the value of an evaluation unit and made both oral and written commitments to set one up.

Background

In his 1983 Report, the Auditor General was already pointing out that Finance was the only major department that apparently felt no obligation to give someone responsibility for program evaluation or to set up an evaluation unit, in accordance with Treasury Board guidelines. In his 1984 Report, the Auditor General noted that the Finance Department had displayed negligence in proposing a research and development tax credit that had cost the taxpayer almost three billion dollars. In the 1985 Report, the Office of the Auditor General highlighted the problems associated with the remission order given to the Hudson's Bay Oil and Gas Company Ltd. It was against this background that the Senate Committee on National Finance and the House of Commons Committee on Public Accounts suggested the regular publication of a tax expenditure account. The Senate National Finance Committee went further, stressing the need to introduce an evaluation function into the Department of Finance that would be separate from the Department's policy function. In 1986, the Auditor General recommended to the Department of Finance that it ensure that tax–delivered programs were accurately evaluated. He suggested that an evaluation framework be set up that reflected the Treasury Board guidelines.

In 1987, the Department of Finance finally yielded to the pressure and acted on the many recommendations. The new unit was to evaluate the effectiveness of fiscal policies in accordance with the guidelines issued by the Comptroller General of Canada.

Given the events that surrounded the creation of the Tax Evaluation Division, and in light of the commitments made by the Department in the past, the decision to put a discreet stop to the Division's activities three and a half years later, without informing the Office of the Comptroller General, is surprising, and could have significant consequences for all Canadians. The Public Accounts Committee therefore deemed it advisable to examine the Department's decision to reorganize its evaluation function and incorporate it into the program function.

The Committee's concerns

Although the Comptroller General argued that the Department's decision did not necessarily endanger the program evaluation function, and that we should wait to see the results before judging the Department's decision, he did acknowledge that the new method of evaluating tax measures was not what he would prefer. The decision is also of concern to the Public Accounts Committee. It puts at risk the independence of evaluations of tax measures and the objectivity of the reporting. By giving responsibility for evaluating the effectiveness and efficiency of fiscal policies to line managers, i.e. the same officials who develop those policies, the Department inevitably runs the risk of creating conflict situations, even if the managers report to a Director General who occupies a staff position outside the authority hierarchy. It is likely that this Director General will co–ordinate evaluations but have neither authority nor influence. There is a good chance he will be kept in ignorance by the line managers when embarrassing results are uncovered. The new method of evaluating tax measures will probably operate smoothly in the short term, but with the passage of time, there is every possibility that senior management's enthusiasm will erode. In addition, by taking this step the Department is losing employees with vast expertise in the evaluation of tax measures, starting with the Division's former Director. The whole "culture" of evaluating the Department's programs has been lost with the decision to eliminate the Tax Evaluation Division.

Furthermore, the Department could set a precedent, with other departments perhaps tempted to disband their program evaluation units. Although the Comptroller General told to the Committee that he would advise other departments not to imitate the Department of Finance, there is no guarantee that this situation will not recur elsewhere. If it should recur, there is nothing that can be done about it, as the Comptroller General does not control the departments: he simply establishes guidelines and checks to see whether the departments are respecting the policy on evaluation programs and doing what is expected of them. Your Committee is thus concerned about the consequences of the Finance Department's action and its possible repercussions.

Lastly, the Tax Evaluation Division was the sole program evaluation unit within the Department of Finance (it was responsible for programs representing a total of more than one hundred billion dollars in tax revenues), despite the fact that the Comptroller General recommends in his guidelines that all programs be evaluated periodically. The Comptroller General told the Committee that the Department had not been able to evaluate all its programs, including its debt–servicing program. The Committee is concerned because this means that the Deputy Minister of Finance is not fulfilling all his responsibilities: he should be applying to the letter Treasury Board's program evaluation guidelines.

Commitments made

Although these concerns remain, the Committee was given firm commitments by the Department of Finance and the Office of the Comptroller General. These commitments do reduce the Committee's apprehension about the consequences of the Department's decisions, but they do not diminish the seriousness of the problem.

The Department's Tax Evaluation Advisory Committee is committed to making public, within the next few weeks, a work plan and a calendar for the next three years, covering evaluations of future tax measures. The Public Accounts Committee concedes that this plan will force the Department to carry out the planned evaluations within reasonable deadlines and will make it difficult to shunt embarrassing reports aside, as was the case recently with the study on the tax treatment of public and private pension plans. Nonetheless, the Committee is very concerned about the studies' lack of independence and the lack of objectivity in evaluations made by line employees reporting to a staff manager without real power.

The Comptroller General's Office has been asked to seat a representative on the Department's Advisory Committee. The Public Accounts Committee is concerned that this representative will probably have very little influence. **Therefore, your Committee recommends that senior officials of Revenue Canada be invited to participate actively in the work of the Advisory Committee, so that they could exert some influence over it. The Committee requests that it be kept informed, on a regular basis, about the work plan for the coming years.** During the meeting of October 8, 1991, the Senior Assistant Deputy Minister did in fact invite the Public Accounts Committee to participate in formulating the work plan. **The Committee has accepted and appends a list of tax measures that it would like to see evaluated by the Finance Department. Starting in 1992, the Committee would also like to see a Tax Expenditure Account published annually as part of the Budgetary process.** Lastly, the Committee has obtained the assurance of the Comptroller General that reports will be prepared on whether the new method of evaluating Finance Department programs work and that the resulting evaluations are free from all line influence. **The Public Accounts Committee also expects the Comptroller General to report to it regularly with a view to determining whether the Department is respecting the Treasury Board guidelines requiring periodic evaluation of all programs.**

The Public Accounts Committee advises other departments against trying to follow the example set by the Department of Finance and disbanding their program evaluation units. In the coming months, your Committee will be keeping a close watch on the reorganization carried out earlier this summer by the Department of Finance.

Finally, the Committee is aware of the major role played by the Department of Finance and its influence in the workings of the government. Consequently, the Committee is very concerned by the high–handed disbandment of the Department's Tax Evaluation Division. **To avoid the creation of a precedent, the Committee recommends increased consultation between the departments and the Comptroller General before any disbandments and that the procedure for these be of a more transparent nature.**

APPENDIX

Tax measures that the Public Accounts Committee wishes to be assessed as part of the three years plan and put at top of the priority list by the Department of Finance:

1. Goods and Services Tax (GST);
2. New tax treatment of Retirement Saving;
3. Tax treatment of capital gains;
4. Tax treatment of flow–through shares;
5. Canadian Exploration Incentives Program (CEIP).

Pursuant to Standing Order 109, the Committee requests that the Government table a comprehensive response to this Report.

A copy of the relevant *Minutes of Proceedings and Evidence (Issues No. 6 and No. 9 which includes this Report)* is tabled.

Respectfully submitted,

JEAN–ROBERT GAUTHIER
Chairman.

REPORT TO THE HOUSE

Monday, November 4, 1991

The Standing Committee on Public Accounts has the honour to present its

THIRD REPORT

Pursuant to S.O. 108(3)e), the Committee has examined Chapter 9 of the 1990 Report of the Auditor General—Information Security Audit.

Computer systems face numerous threats. The growing use of computers in our society has increased the likelihood of information loss and the possibility of fraud and unauthorized access, thereby threatening the security of computerized information. The difference between the speed with which technological changes are being introduced and the speed with which organizations succeed in protecting themselves from criminal acts and computer risks of all kinds only increases the chances that these threats will materialize.

The federal government is not immune to these threats. Computer fraud could prevent the government from properly collecting revenue, hinder the provision of services to Canadians or compromise the confidentiality of information national security could even potentially be threatened. The Committee believes that such situations could put the government's credibility at risk and could also prove politically embarrassing.

Background

In his 1990 Report, the Auditor General examined a sample of 13 departments and identified a number of potential problems associated with the inadequate security of the federal government's computer systems. The comments made were hardly reassuring and perturbed the Committee members. Among other things, the Auditor General pointed out that departments and agencies had failed to assess the threats and risks to their computer systems, had not taken the necessary steps to protect them and had not prepared formal contingency plans. In the event of a major power outage or disaster, the federal government would be unable to provide many essential services.

The government did adopt in 1986 a policy respecting information security and did ultimately approve standards. In so doing, it acknowledged that computerized information needed to be protected. The new standards issued by the Treasury Board Secretariat stipulated, among other things, that responsibility for safeguarding information should rest with departmental senior management. In 1988, the Secretariat recommended that the deadline for full implementation of the policy be extended to 1990. At the time the Auditor General was drafting his report, certain departments were admitting that they would need another two to five years to comply with the policy and the new standards.

Despite this fact, the Treasury Board Secretariat announced to the Committee that the standards would have to be implemented by 1993 at the latest. Treasury Board Secretariat stated that all departments would be required to evaluate their computer systems by this date. The Committee is concerned about the deadline for implementing the Secretariat's standards. At the rate things are going, it is quite possible that by 1993, that is seven years after the standards were first issued, departments may still not have fulfilled their responsibilities with respect to information security.

In light of these facts, it is clear a leadership problem exists within the federal government in the information security field. The Committee is of the view that departments, Treasury Board Secretariat and other concerned organizations are not properly fulfilling their responsibilities.

Observations and recommendations of the Committee

The Auditor General noted once again to the Committee that all of the departments included in the sample had failed to comply with the information security policy and with the standards. The Committee is of the opinion that anyone wishing to act in the information security field must, before doing anything else, assess the risks and vulnerability of computer systems. In order to do so, the proper skills must be acquired. As we just indicated, under Treasury Board Secretariat standards, this task is the responsibility of departmental senior management. The latter have stated that they are not in a position to carry out these assessments or to make the necessary changes because they lack the required expertise and skills.

Treasury Board Secretariat claims that departments and agencies can still contract out the job of conducting these assessments. The Committee doubts, however, that there is a sufficient number of expert–consultants in this field in the National Capital Region to meet the demand. Furthermore, the Committee is concerned about the risks involved if all departments and agencies were to use outside consultants. Information confidentiality could be compromised.

The Public Accounts Committee therefore considers that the Treasury Board Secretariat should play a leadership role. It is meaningless to develop a policy if the policy is not implemented. It should be borne in mind that this policy was originally developed in 1986. Five years later, it is obvious that it has been only partially implemented. Treasury Board Secretariat told your Committee that the departments would have another two years to live up to their information security responsibilities. Unless Treasury Board Secretariat lives up to its own responsibilities, your Committee fears that it will be well beyond 1993 before all departments have complied with what is required of them. Moreover, the Treasury Board Secretariat admitted to the Committee that the departments were just starting to sign contracts with computer consulting firms. Until such time as the assessments are completed and rectifications made, the security of Canadians could be at serious risk.

The Committee recognizes that serious budgetary constraints exist at this time and that resources are limited. In such a context, it is reasonable to allocate resources on the basis of the probability of accidents and risks. However, when resources are limited, leadership becomes all the more important. Training and co–ordination are valuable assets in any attempt to optimize resource use: for example, there are economies of scale when the skills, experiences and contributions of all parties are shared. The leader's role is to see that risks are accurately assessed. To do this, the leader must not only establish a detailed analysis grid, but also ensure that the departments carry out correctly the functions that are assigned to them.

Your Committee therefore recommends

(1) that the respective responsibilities and roles of Treasury Board Secretariat, the RCMP, the Communications Security Establishment of the Department of National Defence be clearly defined, so that they can respond fully to the federal government's needs in the area of information security;

(2) that Treasury Board Secretariat monitor closely the implementation of the standards by the departments. For implementation to be successful, senior managers will have to be made aware of the dangers threatening their installations and of the importance of correcting situations that pose a risk;

(3) that Treasury Board Secretariat exercise a leadership role within the federal government in the area of information security. To this end, it will have to be familiar with the various dangers that could affect government computer systems. It will have to assist and guide the departments so that they can assess the risks inherent in their installations and then make the necessary rectifications.

In conclusion, the Public Accounts Committee wishes to stress that we must not wait for a diaster before taking action! Concrete measures must be taken as rapidly as possible. The Committee considers that waiting until

1993 puts our computer systems, and the information they contain, at risk. A fire at a key installation or a computer fraud could have disastrous and expensive consequences for all Canadians.

Your Committee therefore recommends

> **that a status report be submitted to it in six months' time, with a view to verifying whether substantial progress in information security has been achieved by Treasury Board Secretariat, the RCMP, the Communications Security Establishment and the departments.**

Pursuant to Standing Order 109, the Committee requests that the Government table a comprehensive response to this Report.

A copy of the relevant *Minutes of Proceedings and Evidence (Issues No. 7 and No. 9 which includes this Report)* is tabled.

Respectfully submitted,

JEAN–ROBERT GAUTHIER

Chairman.

REPORT TO THE HOUSE

Wednesday, December 11, 1991

The Standing Committee on Public Accounts has the honour to present its

FOURTH REPORT

Pursuant to Standing Order 108(3)(e), the Committee examined paragraphs 3.26 to 3.30 of the Auditor General's Report for 1990 concerning the Canadian International Development Agency (CIDA) and an aid project to Pakistan.

The appropriateness of economic and social development aid to less advanced countries cannot be questioned. If we are to release these countries from trap of poverty, the problems of demography, urbanization and industrialization must first be solved. Canada has a significant role to play in this regard. The federal government has given the Canadian International Development Agency virtually all responsibility for international cooperation. In 1991–1992, CIDA will manage a budget of $2.34 billion from a gross total budget of $3.18 billion allocated for public development assistance.

In addition to promoting economic and social development, this aid also benefits Canadian exporters because it is often tied to purchases of Canadian goods and services. However, budget constraints, which will henceforth be omnipresent in the machinery of government, are forcing Canada to evaluate the exact manner in which taxpayers' money is spent so as to ensure it is properly managed. It was with these objectives in mind that the Committee tried to determine whether CIDA was optimizing the extensive resources at its disposal. The recent example of a CIDA project in Pakistan raised in the Auditor General's Report for 1990 suggests that some managerial practices are not sound and that Canadians have cause for concern.

Context

In 1975, Canada signed a bilateral agreement with Pakistan to finance construction of a coal–washing plant through a $1.6 million line of credit. It was agreed that a Canadian company would provide the necessary equipment. The project began two years later, and the coal–washing facility opened its doors in April 1980. According to the Auditor General, the project's objectives were not achieved since the plant has produced less than one per cent of its designed output since it opened. CIDA states it is not accountable for the failure of the plant.

The purpose of the coal–washing facility was to produce higher quality coal to be used in steel manufacturing in Pakistan. The coal's sulphur content, however, proved to be too high. The objective of this entire operation was to reduce imports of high quality coal and thus the need for foreign currency.

Before financing the project, CIDA did not assess the risks to evaluate whether the project was viable. It failed to determine clearly who its potential purchasers might be or how the coal would be transported to end users. Furthermore, the equipment manufactured by the Canadian company (Cyclone Engineering Sales of Edmonton, Alberta) could not be used to process the type of coal available. CIDA realized this fact one year after the equipment was delivered and installed. It had nevertheless received preliminary indications from the Pakistani government, the Canadian Embassy and CIDA agents in the field that the coal–washing project was in serious difficulty.

CIDA subsequently contributed more than $750,000 to restart the plant, but ultimately abandoned the project in 1984. Thus, the Agency's total outlay for the coal–washing project was $2.3 million. In the Auditor General's view, "...since the plant totally failed to meet its design objectives, there was little value obtained for the money spent on it" (paragraph 3.29). In response, CIDA refused to be held accountable for the plant's failure. It maintained that it was not the only organization involved in the project and that a number of factors were therefore beyond its control. According to CIDA policies, the debtor government is responsible for ensuring the project operates smoothly when it is financed through a line of credit. CIDA claims that a transaction conducted through a line of credit must be seen as a delegation of authority to the beneficiary country. CIDA adopts a non–interventionist approach. The beneficiary country takes responsibility for feasibility, management and control of the line of credit. CIDA is simply concerned with payment in the name of the organization responsible for purchasing. For this reason, CIDA claims that risk evaluation and therefore responsibility in case of failure are not its responsibility. This was also the reason CIDA refused to acknowledge accountability for the failure of the plant. The Agency claims that, if full feasibility studies had to be conducted for all transactions of this type, their administrative cost would be high and they would monopolize scarce resources.

Committee's Concerns

When the Committee on Public Accounts asked CIDA whether, in future, it would systematically conduct feasibility studies and risk assessments, in all cases, without exception, or whether it would authorize an authority competent in the evaluation field to do so, regardless of the method of financing, the Senior Vice–President answered unequivocally, "No". The Committee on Public Accounts is concerned. Situations such as the one in Pakistan could occur again. Millions of dollars could be wasted.

Parliamentarians must answer voters' questions on the appropriateness of foreign aid, particularly in the context of budget cutbacks. Consequently, the Committee feels that parliamentarians must be in a position to confirm that spending was indeed justified. Although CIDA may consider that the amounts invested in projects such as the Pakistan project are not very high, most Canadians certainly do not feel that way.

The Committee acknowledges that CIDA operates in a sphere in which risks are very high and admits that possibilities of failure will always exist, even given the best possible administrative practices. The Committee does not expect perfect performance from CIDA. However, the Committee observes that, in not assessing the risk or authorizing an international development expert to do so, CIDA fails to comply with Treasury Board directives as stated in Chapter 540, paragraph 2.1, of its Administrative Policy Manual entitled "Management and Control of Projects", which provides for the "comprehensive assessment of the degree of risk in meeting the objectives". CIDA states that it complies with these directives by assessing financial risk when it grants a line of credit to any country. This is far from satisfying the Committee because the Agency provides no concrete follow–up except through random evaluations. By making the beneficiary country responsible for invested sums, CIDA loses too much control over public funds. Although the Committee recognizes the importance of having developing countries take part in projects concerning them, the fact nevertheless remains that Canadian taxpayers' money is ultimately involved. The Agency is responsible for ensuring that these assessments are conducted.

CIDA limits its responsibility to financial control over the line of credit. The Committee would nevertheless expect the Agency to recognize its share of responsibility when a project, conducted solely or jointly with other countries, fails, even if the risks were deemed reasonable and that it would do so no matter the method of financing used. Furthermore, the Treasury Board Administrative Policy Manual is clear on this point. Paragraph 3.5.2 of Chapter 540, concerning accountability, reads: "When more than one department or agency is involved in the implementation of a project and there is no project charter or letter of agreement defining the responsibility and accountability of the participants, *the department seeking project approval shall be totally accountable*."

In the Committee's view, the Agency clearly contravened Treasury Board directives. CIDA was unable to show it had reconciled its own management practices regarding risk assessment and division of responsibilities with those prescribed by Treasury Board. In fact, the Committee on Public Accounts finds the Agency's position entirely unacceptable and believes that, if good management practices were in effect at CIDA when it approves projects such as the Pakistan project, the risks of failure would be considerably attenuated. In the past fiscal year, 332 projects totalling more than $100 million involved transactions through lines of credit. Considering the size of the sums involved, the Agency should clearly use risk assessment methods and follow a clear policy for dividing responsibilities in case of failure.

The Committee realizes that these changes would likely impose major operational constraints since CIDA would be obliged to allocate resources to functions which are currently ignored. However, the Committee believes that a choice must be made between a flexible policy that involves a number of financial risks and a more restrictive method for approving aid projects while maximizing their chances for success. CIDA should perhaps do less, but do it better. While awaiting the outcome of this process of reflection, the Committee on Public Accounts, and Canadians in general, must have assurances that the amounts allocated to development projects will henceforth be properly managed.

Recommendations

In the light of the above observations, the Committee on Public Accounts recommends:

that CIDA undertake, as required by Treasury Board, full risk assessments of all projects financed under lines of credit and in which the Agency takes part solely or jointly. The extent of these assessments should obviously be directly proportional to the level of CIDA funding.

The Committee finds it unacceptable that CIDA does not acknowledge its share of accountability on the ground that it does not control all aspects of a project. The Agency has no other choice than to render accounts to Parliament and to Canadians when projects fail. The Committee is obviously of the view that it should not be held accountable when a project fails as a result of extraordinary or unforeseeable circumstances (such as a rebel attack on a food convoy). However, when the Agency decides to finance a project, it should do so because it has evaluated that project's probability of success and found it satisfactory. If such a project fails through administrative errors, the Committee believes that CIDA has no other choice but to be held accountable, except where a prior agreement existed among the various parties to share accountability in case of failure.

Consequently, the Committee recommends

1) **that CIDA acknowledge its responsibilities and errors when a project fails in circumstances that were under the Agency's control;**

2) **that CIDA share risk and responsibility in all projects in which it decides to take part with partners. CIDA's accountability should thus be clearly defined in advance for every project in which the Agency takes part.**

Lastly, the Committee wishes to emphasize the lack of openness in CIDA's communications. During the two meetings on Pakistan, there was considerable confusion surrounding terms used. For example, the term "line of credit" was used, when in fact we were discussing a grant. If parliamentarians are to explain CIDA's activities to their voters, they must be able to understand them themselves. The Committee wasted a great deal of time decoding the bureaucratic language which CIDA used during the two meetings on this subject. The Committee was also not satisfied with the manner in which CIDA answered the Committee's request concerning the number of projects which are financed through lines of credit and which are in danger. CIDA merely provided a written list of line of credit transactions. The Committee's request was nevertheless legitimate if one accepts the argument that Canadians have a right to know. The Committee expects to receive from CIDA a list of projects in difficulty.

Pursuant to Standing Order 109, the Committee asks the government to table a comprehensive response to this report.

A copy of the relevant *Minutes of Proceedings and Evidence (Issues Nos. 8, 11 and 13 which includes this Report)* is tabled.

Respectfully submitted,

JEAN–ROBERT GAUTHIER

Chairman.

REPORT TO THE HOUSE

Friday, March 13, 1992

The Standing Committee on Public Accounts has the honour to present its

FIFTH REPORT

In accordance with Standing Order 108(3)(e), the Committee has examined the Public Accounts of Canada for 1990–91, in particular Volume I, section 2 (Audited Financial Statements of the Government of Canada).

Background

Pursuant to the *Auditor General Act*, the Auditor General is responsible for examining the financial statements of the government to ensure that "they present fairly information in accordance with stated accounting policies of the federal government and on a basis consistent with that of the preceding year" (s. 6 of the *Auditor General Act*). Following the latest audit, the Auditor General issued three major reservations about the Public Accounts of Canada for 1990–91. They deal with what he considers to be improper accounting for: income tax collected on behalf of the provinces and territories, the impact of wage restraint on federal employee pensions and the reduction in the value of the federal investment in Petro–Canada. These three reservations cast into question the fairness of the government's financial statements. According to the Auditor General, had the government adjusted its financial statements for the matters reported in these three reservations, the deficit for 1991 would have increased by $2 billion, liabilities would have increased by $800 million and the accumulated deficit at the beginning of 1991 would have declined by approximately $1.2 billion.

A. Accounting for income tax revenue collected on behalf of provinces and territories

The Public Accounts Committee is pleased with the Comptroller General of Canada's announcement that he plans to undertake a study of a method that would provide for an improved split of income tax collected between the federal and provincial governments.

Nevertheless, the Committee recommends:

that more accurate estimations of income tax revenue collected on behalf of provinces and territories be used when issuing the next Public Accounts of Canada for 1991–92.

B. Accounting for the effect of wage restraint on federal employee pensions

In light of the government's wage restraint provisions (more commonly known as "zero–three"), actuarial liability for federal employee pensions must be adjusted downward. To determine the value of future employee benefits and considering that wages are not increasing at the projected rate, the government must review employee pension liabilities accordingly. The required adjustment has been estimated by the government at $1.367 billion.

The full amount of this reduction has been offset against the 1991 deficit. The problem is that the government has used accounting standards which it has interpreted in its own way. In this particular case, the government has used this method to determine the impact of wage restraint, as it believes its decision would result in a permanent reduction in employee pension liabilities. This decision is based on the government's position that wage restraint represents a permanent reduction in the pension benefits likely to be paid to employees. The government is assuming that employee pensions have been permanently reduced and that federal employees will never recover the amounts lost during future rounds of collective bargaining because of financial pressures.

Had the government used the accounting practices suggested by the Public Sector Accounting and Auditing Committee (PSAAC) of the Canadian Institute of Chartered Accountants (CICA), that is if it had spread the effects of short–term wage restraint on employee pensions over the remaining working lives of employees rather than include them in the deficit of the current year, the actuarial impact of wage restraint would have been spread over a thirteen–year period.

The Public Accounts Committee believes that paragraph .55 of Public Sector Accounting Statement 5 (*Accounting for Employee Pension Obligations in Government Financial Statements*, November 1988) dealing with a plan curtailment cannot be interpreted differently. According to PSAAC, two events must come into play in order for a pension plan to be curtailed, namely: "an event that reduces significantly the expected years of future service of present employees or [one that] eliminates, for a significant number of employees, the accrual of defined benefits for some or all of their future services".

In the opinion of the Public Accounts Committee, short–term wage restraint is not conducive to the occurrence of either of these events. Furthermore, nothing guarantees that employees will not succeed in making up the shortfall resulting from wage restraint prior to their retirement. The future is too uncertain to make this kind of actuarial assumption. Even the government's Chief Actuary noted in his *Actuarial Report on the pension plan for the Public Service*, which was tabled in the House of Commons on October 11, 1991, that "because future economic conditions cannot be predicted with a high degree of probability, and because it is inadvisable to make large changes in assumptions from one actuarial review to the next...", underlying economic assumptions cannot be modified. In the Committee's opinion, the government is not applying the accounting and actuarial standards proposed by its Chief Actuary.

The Public Accounts Committee also heard testimony from two witnesses who explained generally accepted accounting principles. John Kelly, Director, Public Sector Accounting and Auditing of the Canadian Institute of Chartered Accountants, said that PSAAC Accounting Statement 5 was quite clear. When he appeared before the Committee on February 18, 1992, he stated:

> [C]hanges in assumptions such as those related to future salary increases and the related experienced gains and losses are spread over the remaining working life of the employee group. The effects of these changes are spread because their impact on the determination or calculation of the pension obligation cannot be estimated with certainty. In my mind, a plan curtailment is a permanent change that reduces the size of the work force or changes the structure of the pension plan so the amount of future benefits is reduced. (*Minutes of Proceedings and Evidence, Issue No. 17, page 7*)

At the same meeting of the Committee, Joseph Weinstock, an actuary from William M. Mercer, stated:

> In my experience, a wage restraint does not constitute a plan curtailment. (Issue No. 17, page 9)

The Public Accounts Committee is therefore of the opinion that the accounting method used by the Comptroller General in calculating the actuarial effects of wage restraints in the Public Accounts of Canada for 1990–91 contravenes PSAAC Accounting Statement 5. By not applying generally accepted accounting methods, the government is violating a principle of elementary financial prudence.

The Committee therefore recommends:

(1) that the government correctly account for the actuarial liability associated with wage restraints, by not treating the repercussions of the *Public Sector Compensation Act* as a curtailment of the federal employees' pension plan. Consequently, the government must amortize this actuarial adjustment over a thirteen–year period, as is generally accepted in sound accounting practice;

(2) that, as soon as possible, the government publish corrected financial statements for 1990–91 that perfectly account for the actuarial impact of wage restraints and correctly reflect the repercussions of wage controls spread over two years rather than three.

In addition, the Public Accounts Committee fears that the Comptroller General anticipated the passage of Bill C–29 (*Public Sector Compensation Act*) in preparing the Public Accounts of Canada. Such a procedure anticipates the intent of Parliament and is unacceptable; that this was the case is clear from the Comptroller General's error in assuming that wage restraints would be spread over three years, while in fact Parliament eventually adopted a policy of wage restraints spread over two years.

C. Reduction in the value of the federal government's investment in Petro–Canada

In July 1991, the federal government reduced its share in Petro–Canada from 100 to 80 per cent by selling shares at $13 per share. In this way, the government revalued its remaining investment in Petro–Canada to correspond to this price. The sum of $1.25 billion was deducted from the value of this asset. The government feels that the impact of this adjustment should not form part of the deficit for the current fiscal year and should be charged to a preceding fiscal year. The government considered it appropriate to apply the adjustment to the fiscal years during which the investment was made in Petro–Canada, that is, 1984. The Comptroller General thinks that the best way of reflecting these changes is to charge this adjustment to the years in which the investments were made.

The Public Accounts Committee is of the opinion that good accounting practice would require that this adjustment to asset valuation allowances be charged off to the current fiscal year, and that retroactive adjustments are unacceptable unless there has been an error in an entry or a change in accounting principles.

As the Auditor General noted before the Public Accounts Committee, the federal government's investment in Petro–Canada had been valuated downward two years previously and had been accounted for as a current year transaction. The Auditor General emphasized that, in his opinion, there was a contradiction between the accounting entry used in 1990–91 and the one used in similar circumstances in 1988–89. The Auditor General also noted that there was a risk of transactions disappearing if adjustments were made to previous years without valid reasons.

The Public Accounts Committee therefore recommends:

(1) that the adjustment to the value of the federal government's investment in Petro–Canada be charged off to the 1990–91 fiscal year, the year during which it was identified;

(2) that, as soon as possible, the government publish corrected financial statements that faithfully reflect the value of the federal government's investment in Petro–Canada;

(3) that the government adopt accounting practices that would respect PSAAC Accounting *Statement 4 (Defining the Government Reporting Entity*, November 1988) on accounting for investments in Crown corporations. The government would thus account for Crown corporations' net losses (or gains) as part of its own losses, at the time they occurred.

Conclusion

The accounting practices used by the federal government must measure, record and report economic and financial information, clearly and as accurately as possible. As John Kelly stated at the August 1991 annual meeting of the Canadian Council of Public Accounts Committees in Winnipeg, "solid, reliable, complete information is essential for sound planning, good decisions and full accountability." The Public Accounts Committee is of the opinion that if the government wishes to appropriately plan its activities, and increase the effectiveness of its decisions and its accountability, it has no choice but to ensure that generally accepted accounting principles are used when it prepares its financial statements and that the accounting principles are less often the subject of different interpretations. The federal government's transparency and accountability are jeopardized if the information conveyed to Canadian parliamentarians and taxpayers is fragmented, incomplete and unreliable. It is essential that information on the government's financial statements be based on consistent and sound accounting principles.

Pursuant to Standing Order 109, the Committee asks the government to table a comprehensive response to this report.

A copy of the relevant *Minutes of Proceedings and Evidence (Issues Nos. 14, 17 and 19 which includes this Report)* is tabled.

Respectfully submitted,

JEAN–ROBERT GAUTHIER

Chairman.

REPORT TO THE HOUSE

Wednesday, April 8, 1992

The Standing Committee on Public Accounts has the honour to present its

SIXTH REPORT

In accordance with the Order of Reference of Thursday, February 27, 1992, your Committee has considered Vote 30 under FINANCE in the Main Estimates for the fiscal year ending March 31, 1993, and reports the same.

A copy of the relevant *Minutes of Proceedings and Evidence (Issues Nos. 21, 22 and 23, which includes this Report)* is tabled.

Respectfully submitted,

JEAN–ROBERT GAUTHIER

Chairman.

REPORT TO THE HOUSE

Wednesday, April 29, 1992

The Standing Committee on Public Accounts has the honour to present its

SEVENTH REPORT

Pursuant to Standing Order 108(3)(e), your Committee again examined the disbandment of the Department of Finance's Tax Evaluation Division in light of Chapter 3 of the Auditor General's 1983 Report—Program Evaluation.

On November 1, 1991, the Public Accounts Committee tabled its second report to the House, dealing with the disbandment of the Department of Finance's Tax Evaluation Division. After hearing the officials responsible for this decision, the Committee decided to table a report in order to make known the concerns raised by the disbandment of the Department of Finance's only program evaluation unit.

At the meetings on October 8 and 10, 1991, the Department of Finance assured the Committee that the new tax measure evaluation method would operate smoothly. However, these officials maintained it would be necessary to wait and see results before judging the Department of Finance's decision. They reassured the Committee by stating that a Tax Evaluation Advisory Committee (a Department of Finance committee chaired by a Director General who occupies a staff position outside the authority hierarchy) would ensure that evaluations were conducted independently and in accordance with the rules.

The events that occurred during the examination of the disability tax credit—which are disquieting, to say the least—have incited the Public Accounts Committee to continue its examination of the Department of Finance's decision to disband its Tax Evaluation Division. Indeed, the government's response to the Committee's second report and correspondence exchanged with the Deputy Minister of Finance in recent months have not at all convinced the Committee that everything is unfolding as it should.

These recent events tend to show that the program evaluation has not been without difficulty since the Tax Evaluation Division was disbanded. The Public Accounts Committee is concerned and its members have serious questions. It does seem that problems occurred at the first occasion with the new tax measure evaluation method. The examination of the disability tax credit has confirmed exactly what the Committee feared several months ago. The Committee admits, however, that several months will still be required before it is able to judge whether the new tax measure evaluation method is working.

The Public Accounts Committee therefore recommends:

(A) that the Auditor General examine in depth, on the Committee's behalf, the Department of Finance's new tax measure evaluation method, in light of the events that occurred during the examination of the disability tax credit, and using the evaluations called for in the Department of Finance's 1992 work plan;

(B) that he submit a detailed report to the Public Accounts Committee in early 1993.

A copy of the relevant *Minutes of Proceedings and Evidence (Issue No. 24 which includes this Report)* is tabled.

Respectfully submitted,

JEAN–ROBERT GAUTHIER

Chairman.

Appendix D

Report on the Audit of the President of the Treasury Board's Report to Parliament:

Tablings in Parliament: Parent Crown Corporation Annual Reports and Summaries of Corporate Plans and Budgets

REPORT ON THE AUDIT OF THE PRESIDENT OF THE TREASURY BOARD'S REPORT TO PARLIAMENT

TABLINGS IN PARLIAMENT: PARENT CROWN CORPORATION ANNUAL REPORTS AND SUMMARIES OF CORPORATE PLANS AND BUDGETS

Introduction. The Financial Administration Act requires the President of the Treasury Board to lay before each House of Parliament a report concerning the timing of tabling, by appropriate ministers, of annual reports and summaries of corporate plans and budgets of Crown corporations subject to the reporting provisions of Part X of the Act.

This report allows Parliament to hold the appropriate ministers (and, ultimately, the Crown corporations) accountable for providing it, within the relevant statutory deadlines, with information required under the Financial Administration Act. Accordingly, the report is required to indicate the annual reports and the summaries of corporate plans, capital budgets and operating budgets (and amendments to them) that were to be tabled before each House during the reporting period; the time at, before, or within which they were required to be tabled; and the time they were actually tabled.

Scope. I am required by subsection 152(2) of the Financial Administration Act, to attest to the accuracy of the information contained in the report on Crown corporations tabled by the President of the Treasury Board. Accordingly, I have examined the report indicated above for the year ended 31 July 1992, to be tabled not later than 31 December 1992*.

My examination included a review of the systems and procedures used by Treasury Board to monitor the tabling of the summaries and annual reports in each House of Parliament, a verification of the information contained in the report, and such other tests and procedures as I considered necessary in the circumstances.

Conclusion. I have concluded that the report listed above contains all the required information about the timing of tabling, by the appropriate ministers, of Crown corporations' annual reports and summaries (and amendments to them) of corporate plans, capital budgets and operating budgets, and in my opinion, the information contained in the report is accurate in all significant respects.

L. Denis Desautels.

L. Denis Desautels, FCA
Auditor General of Canada

OTTAWA, 26 October 1992

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* Not tabled at time of going to press